

INDUSTRIAL  
ORGANISATION  
AND  
INDUSTRIAL  
FINANCE



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# **INDUSTRIAL ORGANISATION AND INDUSTRIAL FINANCE**

**BY**  
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**WITH FOREWORD BY**  
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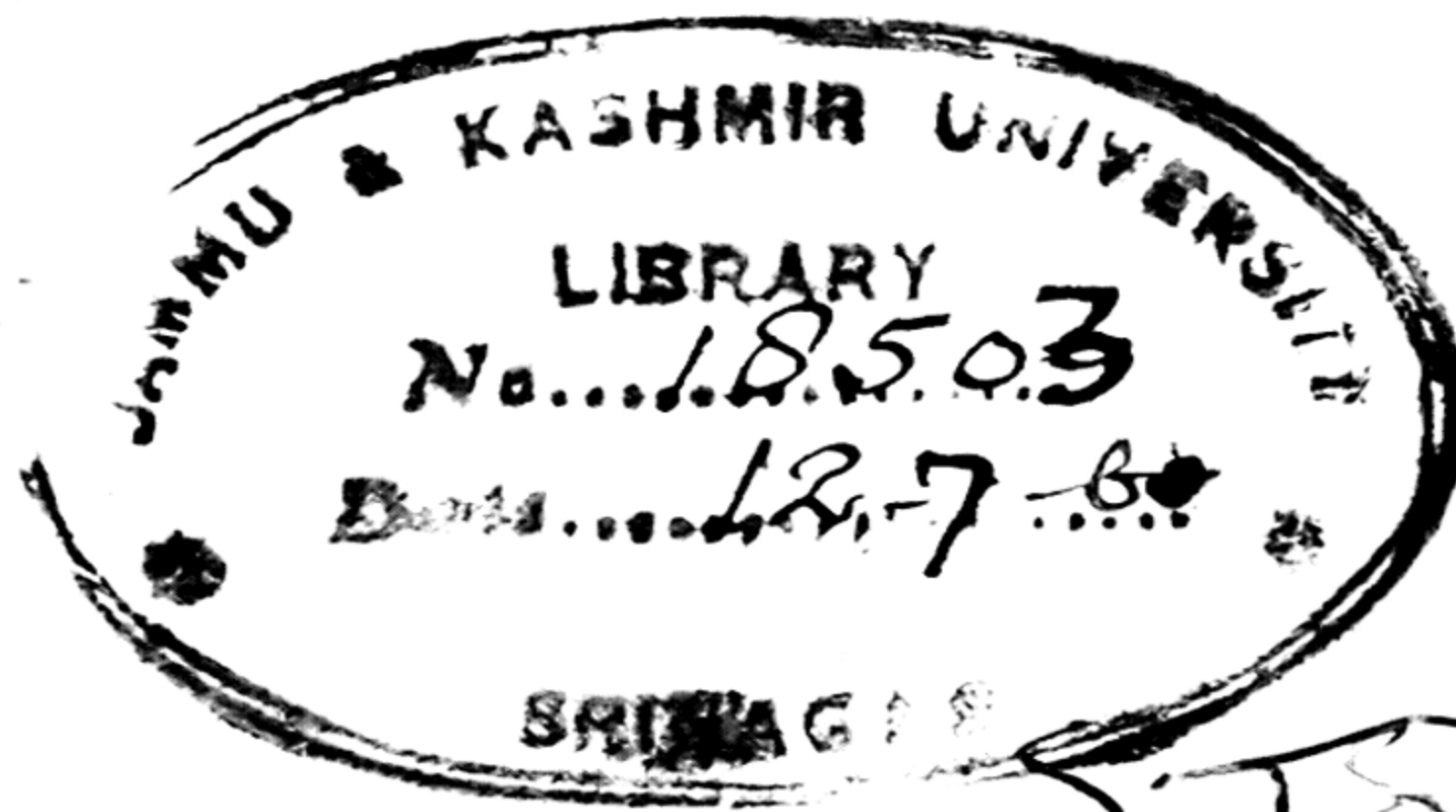
*Also by the same author*  
**BANKING FRAUDS IN INDIA**

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## FOREWORD

With the beginning of the new industrial revolution in our country coinciding with our Independence, it is indeed very heartening to find a publication on 'Industrial Organisation and Industrial Finance' by the able pen of Mr. V. R. Sonalker. When so much is expected to be achieved in as quick a time as possible through greater industrialisation in our land for our very urgent economic progress, it is essential to have a fairly broad idea about the fundamental aspects of industrial organisation and industrial finance. Mr. Sonalker's book can be truly said to fulfil that need at the appropriate moment. For the success of our Plans, the background for starting and financing of industries ought to be widely known and explained in simple and appropriate terms.

The author of this book has made a laudable effort to do this and there is no doubt that it will be regarded as a constructive piece of effort in the task of achieving faster industrialisation, which has been set before our nation by our leaders as essential for our economic regeneration.

In modern India it has been rightly decided to have a broad base for industrial enterprise. We need not have a few hundred industrialists, but a few millions, big, medium and small. We need even many of the so-called self-employing industrial ventures which have enormous scope in our fast



developing sub-continent. For starting all this on a solid foundation, basic information of the type to be found in Mr. Sonalker's publication is essential. The success of modern industries depends to a large extent on careful planning, constant attention to efficiency and productivity, a dynamic outlook and keeping abreast of the latest developments in production and marketing. All these depend on proper organisation and sound management and many valuable hints in this respect are found in several parts of Mr. Sonalker's lucidly written publication.

Mr. Sonalker has had a wide and varied experience about matters pertaining to industrial organisation and finance. With the specialised knowledge he has acquired as a former Managing Director of the Industrial Finance Corporation of India, it is quite proper for him to have made this useful attempt and published this book. One confidently feels that this effort of Mr. Sonalker will prove of use not only to students and those contemplating to play their role in the thrilling task of building up industries, but also to those already bearing the burden of management of industries. A perusal of Mr. Sonalker's publication leads one to desire that there should be other similar books from those who have deep insight into similar complicated matters which are of vital interest to our economic progress and prosperity.

28-12-59.

C. H. BHABHA.



## PREFACE

The industrial development and economic advancement of a country can take place only when the Government has definite policy of encouraging industries, the banks in the country are capable of playing their role satisfactorily and the entrepreneurs are honest, hard working, and capable of pursuing their schemes with ability and courage. The administrator, the technician and the worker have also to equip themselves for adequately discharging their responsibilities.

Government of India is no doubt going ahead with its schemes of promoting industrialization. It is for the other sections to make their own contributions.

The entrepreneur will be benefitted if he can have handy reference to tell him what are generally the basis on which his scheme is to be formulated, what were the mistakes committed by other promoters in a hurry and what important items he should tick off before his plans are put into execution.

Almost every factory requires the banker's help for its working capital and most of the factories will require medium or long term loans for expansion or modernization, often in their careers. The need for assistance, often arises on account of the force of circumstances and there is often very little time, if the favourable opportunity is not to be lost. Every factory must, therefore, know what scrutiny the financial institution will make and how it should be in a position to satisfy the lender's requirements in the shortest possible time.

If the industrial development takes place on the scale envisaged by the Prime Minister—and there is no doubt that it will happen—the bankers will have to play a great part not only in financing of industries, but in industrial finance. To diagnose the health of industries, they are called upon to help, the bankers must possess some knowledge of the Anatomy and Physiology of the industries. An attempt is therefore, made to explain in brief,



how industries are started, how they work, what factors promote or affect their health and what remedies are applied in particular cases.

Lack of industries on a much wider scale, has been responsible for lack of knowledge about the detailed working of industries. The engineers have, therefore, generally confined themselves, to their own particular sections as technicians. They would be able to do much better if they knew how, why and where industries are started, how they function and what are the factors that help or hinder their progress.

The Administrator will be more sympathetic if he knew the trials and tribulations through which the industries have to pass and how prompt attention to their grievances promotes general welfare of the community.

The average well placed worker, is generally ambitious and obliging. If he is convinced that profits just do not flow in on account of the mere establishment of the factory, but accrue as a result of careful planning, astute bargaining, watchful avoiding of waste, able management of financial resources and masterly handling of all difficulties, he would exert his influence to see that the work in his factory proceeds in a manner conducive to smoother and more efficient production.

Before the Second World War, people in India, believing that running of an industry was a highly specialized job, were generally indifferent to the industries and their working. The quick succession in which so many factories sprang up during the war-period and the large profits the promoters, without knowledge or equipment, made in a short time, changed the attitude of the public to industries in general.

National interest demands that all questions connected with industries should be viewed in proper perspective.

This book has touched upon many points, each of which will require a special treatise, if they are to be discussed for the benefit of novices. Manuals cannot make managers. Command of the fundamental, is the basis of knowledge, which becomes power if used with circumspection, diligence and firmness. It is presumed



that the readers will be acquainted with the theory or will have some experience of Industrial organization or Financial Machinery and will be able to appreciate the varied information on the several points of practical importance.

This book has been primarily written for ambitious bankmen and students in Commerce and Engineering Colleges. It is however hoped that it will not only prove of interest to all those, who have to deal with industry but will also contribute towards generally improving the understanding of Industry, its functions and its problems.

Inspections inevitably bring out good and bad points. Certain points requiring attention, had to be shown as coming to light in Inspections in Part II, Chapter IV. They have not been inserted as carping criticism. They are expected to aid industrial concerns in putting their house in order and presenting to the bankers and other finance institutions such clean, clear and well documented cases as, the writer during his visits abroad found, were placed before the International Bank for Reconstruction and Development, Washington, Industrial Development Bank, Montreal, the Herstel Bank, the Hague, and the Industrial Credit and Finance Corporation Ltd., London. In the cases of the foreign institutions the money could be made available without undue delay.

My sons P. V. Sonalker, B. Sc. (Mech. Eng.), London, and M. V. Sonalker, C.A., were able to go through the book only at a very late stage, but were able to make valuable suggestions.

The writer is very much obliged to Miss Parveez K. Viccaji, B. A., for taking down some part of the book in shorthand, transcribing it and correcting hundreds of sheets typed by others. Her clear thinking and her experience in journalism in England were helpful in arranging the subject matter and in the printing of the book.

I cannot adequately express how grateful I am to Mr. C. H. Bhabha for going through my book and for writing the "Foreword".

15th August 1959.

V. R. SONALKER.







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# INDUSTRIAL ORGANISATION

## CHAPTER I

### Principal Types of Industrial Organisations:

The setting up an industry did not present any problem of organisation when the wants of every village of some size were easily met by its carpenter, blacksmith or cobbler.

The problem began to develop with the advent of machinery. The machine could, in the beginning, do the work quicker, later it began to give more work continuously and during the same period of time began to turn out many times more production than one man could do, working with his own hands.

With progress in the performance of the machines, each could do many jobs replacing several manual workers. Machines brought down the costs of production.

Machine-made goods, therefore, sold cheaper than goods produced by hand.

The process that made possible greater production at cheaper costs with the aid of machines is known as the Industrial Revolution.

The countries which could invent or use such useful machines benefitted greatly and in proportion to the daring, business acumen and love of travel their own nationals showed, in selling in far off lands at cheaper rates, the goods manufactured by the newly invented machines. Naturally, the industries in backward countries, which were operated by hand, suffered from the competition and were totally ruined in many countries.

As the traders of the advanced countries, selling goods abroad prospered, they wanted their countrymen to produce more and more goods on the machines.

The stage was therefore set for large-scale production with its attendant headaches unknown to the cobblers, potters, or blacksmiths.



Producing on a very much larger scale, required more and better machinery, more raw materials, larger godown space for both raw materials and finished goods, more division of work, larger labour force and most important of all, larger finance both for buying machines and materials, and for paying men.

Attaining huge production did not solve all the problems, for large production by itself does not bring profits. It created the nightmare of selling what was produced, and forced the producer to study intelligently all factors which affected, or were likely to affect adversely, his sales.

The population of the world has increased many fold since the revolution which first introduced the use of mechanical aids on an appreciable scale in production. The needs, hankerings and fancies of the peoples for newer types of food, clothing, shelter, transport, amusements, recreations etc., have also multiplied.

The competition in supplying these new needs at competitive price, has since then brought about many further revolutions introducing the uses of electricity, atomic energy, chemicals etc., confronting the entrepreneur with a bewildering variety of industrial machines and processes to choose from at the time of deciding to set up a big factory.

When the size of an average economic or profitable factory began to increase, the person intending to start a factory found that he could not, by himself, put in all the money required for erecting the buildings, for purchasing the machinery and for working the factory. It was also clear to him that he could not run the factory without the help of several other persons possessing knowledge and experience of managing the different departments, required to be maintained by a large modern factory to cover purchases, production, sales, maintenance of machines and administration including complying with laws and regulations, governing his industrial unit.

Finding the large sum of money for establishing the factory was solved by the expedient of forming a joint stock company offering other people shares in the ownership by inviting them to buy shares in the company.



The banks came forward to accommodate honest industrialists for their genuine and reasonable needs for running their factories.

The more difficult problems, which face the entrepreneur are those of choosing the right type of industry, setting it up in the most suitable place, getting enough production of high quality and selling enough of the production at remunerative prices to leave enough surplus over the expenses to cover (i) dividend or reward to people who risk their savings by buying shares (ii) depreciation, the fund that must be built up to replace machines as they wear off on account of use, (iii) taxes which the various Governments levy on the profits and production.

The running of a big industry successfully has in recent times become a very taxing job requiring study, vision, initiative, courage, dynamic energy and utmost vigilance.

The institutions financing industries or extending industrial finance to industrial units are therefore, very critical in examining all aspects of the actual or proposed running of the industrial concerns which approach them for assistance.

### **Owned by Joint Stock Companies :**

Modern industrial units require costly machinery, big buildings and larger stocks of raw materials and components. They also have to keep on hand a considerable part of the large production. They are called upon to pay an ever-increasing wage bill. They, therefore, require large capital. Few people are rich enough to start big factories with their own funds and fewer still will risk a very large portion of their wealth in trying out a new venture.

Most promoters therefore, approach the general public to take shares in the companies which are floated to start new industrial concerns.

Most industrial concerns of some size are therefore, owned by Joint Stock Companies.



### Owned by Government:

Ownership of certain types of industrial organisation is thrust upon governments on account of their duty to defend the country. They have to maintain Ordnance Factories for the Army, Naval Dock Yards for the Navy, Aeroplane Factories for the Air-force, P.W.D. Workshops for maintenance of roads and aerodromes, and Railway Workshops, for railways owned by Government.

Governments, as sovereign authorities in their own countries, are not restricted to owning only such establishments as are required for the defence of the country.

The countries, which benefitted from the industrial revolution in the last century, secured a great start in world trade by offering machine made products at cheaper rates - often artificially cheaper rates - making it difficult for the less-advanced countries to progress economically. The industrially advanced countries further maintained their leadership by devoting to research some of the profits earned by selling goods like ordinary necessities of life to under-developed countries which felt helpless against the competition for some time. The race between the giant and the dwarf could not go on for ever. The dwarf had to be armed and giant had to be handicapped. The governments of the underdeveloped countries decided to put up large factories as state-owned projects to manufacture basic needs of industries like steel and heavy chemicals and also to undertake production of articles like heavy machine tools, and big generating sets etc., production of which had no attraction to private enterprise because of the large capital outlay required and the restricted markets. The governments also adopted the principle of giving protection to indigenous industries and levied heavy import duties on goods imported from abroad.

Governments are free to undertake the manufacture of anything, but in countries where free-enterprise system prevails the governments generally are not expected to take up-on themselves the production of any items except those which private enterprise should not or cannot handle. This is a healthy rule because governments, often swayed by considerations other than strict

business principles, rush into commitments without proper scrutiny and often lose the tax-payer's money.

Permanent business can be built up only on productive efficiency, highest integrity and scrupulous regard for the general good of the community.

In countries where serious attempts are being made to force the pace of industrial development in order to reduce the dependence on foreign imports, and to lessen the pressure, on land, the governments are adopting "Planning". They do not start the many industries required to make up the deficiency, but are sometimes prepared to subscribe to the capital, on fairly large scales, for ventures started in their territories, which in their opinion, have a fair chance of success.

### **Owned by Co-operative Societies :**

The co-operative movement in India was started in 1904, when the Co-operative Societies Act was passed. Basic principles and methods of co-operatives are :

- (1) Membership open to all.
- (2) Democratic control—one vote to each member and no voting by proxy.
- (3) Small interest on capital.
- (4) Surplus to be divided on the basis of business transacted by the member.
- (5) Education of members on principles of co-operation.
- (6) Co-operative associations to maintain political and religious neutrality.

They are useful in communities which are conscious of their rights and obligations, especially quite suitable for "Purchases" or "Sales" Co-operatives.

The principle of democratic control is likely to be an obstacle when co-operative associations try to run big industries. Political neutrality is likely to be a myth when the major prop of a co-operative unit is Government assistance.



**Owned by Firms Individuals :**

Very few individuals, working in groups as firms, or independently as individuals, can own large factories. It is illegal for a firm to have more than twenty partners. The financing institutions, when they are approached by firms and individuals entertain eligible applications if they are satisfied regarding continuance of efficient management even after the death of the promoter, who has made a success of the enterprise .

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## CHAPTER II

### SETTING UP A FACTORY

#### Selection and Starting of an Industry :

The Curious have often wondered why certain people established their factories at the particular places where they stand and why some industries have conspicuously congregated in certain parts of a large country like India or in certain parts of the globe.

Some are intrigued to know why a particular person or company decided to go in for the manufacture of a certain item.

However wealthy Tom, Dick or Harry might be, they cannot, after a good dinner, decide that the next day Tom will set up a steel plant, Dick will start a cotton mill and Harry will go in for a jute mill, outside their city.

Many factors influence the entrepreneur's ultimate choice of the type of industry to be started and the place where it should be located. The geographical, financial and market factors are very important.

The Australian, in his peculiar circumstances, could only think of pastoral industries like the meat and wool industries. The Indian's first choice was ship-building and cotton textiles. A flash light factory can be put up in Bombay or Calcutta, which are its biggest markets but no person in his senses could think of establishing a sugar mill in the town of Bombay because it is a very large market for sugar. It will have to be in the middle of or near a sugarcane growing area.

A real industrialist makes a realistic appraisal of the financial resources he can command, and the volume of efficient production he himself can manage. The type and magnitude of the proposed industrial venture depend on the finance available to the promoters.



The founder of Kirloskar enterprises, poor man that he was in 1908 had to make a very modest beginning, with about Rs. 15,000 and start making ploughshares. In 1944 Mr. Birla could think of starting a motor car factory requiring crores of rupees. These extreme cases show how all the industrial units between these two ends were planned within the frame-work of finance available.

Ordinarily those industries first spring up in a country which enjoy certain natural advantages in respect of raw materials and ready markets. A country supports more factories making the same goods if the goods are consumer goods i.e. goods which are consumed constantly and have got to be replaced; for instance, cotton clothing, cooking utensils. There will be in a country less and less number of factories producing the same item, as the durability of the product is longer and longer. The number of cycle or sewing machine factories will be less than cotton mills and the number of ship-yards, building ships which last about 40 years, will be fewer still.

Cotton, jute, cement, sugar, vegetable oils, and steel are the industries in which India has natural advantages. She has large markets for capital goods for her industries and also for consumer goods which will help to meet the growing needs of her vast population.

Where natural scope is larger more factories of the same type are set-up and competition is keener.

Industries in backward countries, ruled by foreigners, know that natural advantages by themselves are often not enough, if there is no protection against foreign competition. There is a stage in the industrial development of some countries, when governments are anxious that more and varied types of industries than those that depend for their success on natural advantages alone should be started and developed in the country. They want to reduce their dependence on imports from foreign countries, which have to be paid for mostly by the exporting agricultural produce, like jute and jute products, tea, cotton and wheat. When the foreign countries are engaged in war they cannot export manufactured goods for civilian use in under developed

countries like India and their national have to suffer acute shortages of some of the dire necessities of life.

Governments want to encourage their own nationals to start new industries to manufacture in the country goods which were being imported. The method for giving this encouragement is granting "Protection," which works as follows—For instance if the Government wanted to encourage manufacture of bicycles in the country and their own people could not produce bicycles at less than Rs. 175/- per cycle, but the foreigner, who had been longer in the field could sell a cycle abroad at Rs. 125/- per cycle, the Government will impose a duty of Rs. 70/- on every cycle imported from abroad. The indigenous manufacturer therefore, can sell his cycles Rs. 20/- cheaper than the imported ones.

Industries sometimes also get stimulus when the country is compelled to shut out imports of some goods altogether and to restrict imports of others by fixing quotas, to correct the adverse balance of payments.

This is a time when some kind of vacuum is being filled in and genuine industrialists and adventurers are both sucked into the vortex. There is a race for being the first to start a new type of industry, which was not in existence in the country. The cautious, conservative, capable industrialist is cool and collected and draws up his plans with accustomed care. The nouveau riche and the adventurer is in a hurry. He would bluff the investor, slur over inconvenient obstacles, cajole the planner not to go deeper into details, beg the supplier of machinery to despatch half of the machinery if full workable plant cannot be shipped, will snatch or lure away technicians from other companies and ultimately pay for his follies wantonly ruining himself and also the people who entrusted their savings to him.

### **Difficulties Encountered When Pace of Industrialisation Forced:**

The powerful stimulus given for growth of industries in a country, though beneficial in itself, creates many problems in the transitional period.



1. The concentrated and simultaneous demand on the public for money to set up and run the many and varied new industries, exceeds the savings available.
2. There are not enough technicians with experience and the know-how of the industries.
3. Shortage of skilled workers, reduces the tempo of production.
4. It becomes difficult to know who and how many are going to be the competitors in each line.
5. Countries like India, depending on foreign countries for supply of machinery, find that the aggregate new demand for machinery from the country is creating circumstances in favour of the sellers, who are unable to meet all demands within reasonable time and without sufficiently well-backed guarantors of payment.
6. Shortages of processed raw materials or components are likely to develop.
7. The strain on Foreign Exchange resources is heavy.

### **Licensing of Industries and Control of Capital Issues by Governments:**

In the circumstances where the growth of industries is stimulated by granting of protection and/or restricting of imports, the government of the country is compelled to intervene, first to prevent the precious but short supply of capital (money) available, from being diverted to useless or not so very necessary projects and secondly to stop too many people putting up the same kind of industries when need for different types of industries is so urgent. The control of capital issues and licensing of new and expanding of old industries are enforced by legislation.

### **Choice to be made with care:**

Though the field for selection is vast for the entrepreneur, the choice is circumscribed.

The dazzling profits to be made by the pioneers or first comers charm some people. In that condition, the fools rush in where angels fear to tread. But they are soon repulsed by the

wary investor and are compelled to try their hands at small factories, making lanterns, wire nails, big size bolts and nuts etc. Of this inexperienced and adventurous type, only those who can inveigle into accepting their schemes, ministers of backward states, come forward with grandiose plans which ultimately founder on account of the inherent defects over-looked through ignorance or want of experience.

Instances are also known where budding industrialists, their pockets bulging with war time gains made in trade, went to London, after the end of World War II and offered to purchase a "Watch Factory" or a "Pottery Factory". They had not the foggiest idea of what they really wanted to do and how they should go about it.

At the same time people, who had run small and/or big industries had gone there. They spent their time most usefully in inspecting all new types of machinery available and selected the most suitable, often suggesting some improvements to suit their own conditions and requirements.

It is not the small man that always makes the mistakes. The war made some small industrialists big beyond their dreams. Some of these fortunate people became avaricious and took on too many new commitments and of course paid dearly for their greed and lack of sense of proportion.

*The circumstances which led to the Establishment of the various Factories:* Many industries all over the world have started with a modest beginning due to burning zeal of an individual with grit, vision and infinite capacity to take pains to attain the object of manufacturing something on which he had set his heart and had equipped himself with some knowledge of the industry.

Some were started by men with money who were approached by men who had experience of running such industries or had proposals which could stand the test of feasibility.

Some factories came into being because the men, firms or companies who were importing or selling a particular item on a large scale in this country were convinced that changed



circumstances necessitated establishing factories in this country, to manufacture products they were making in other countries and exporting to India e. g., Glaxo Laboratories, Colgate-Palmolive.

The increase in volume of their production forced some factories to undertake themselves the manufacture of components or processed raw materials which they were buying from others. Cycle factories started making chains etc.

Profitable utilization of bye products of the parent company necessitated the establishment of some industrial plants. Sugar mills added distilleries and power alcohol plants.

A few factories trace their origin to fortuitous circumstances. For instance, a few first class cotton mills which were not allowed either to expand or to instal up-to-date machinery or automatic looms, utilized their surplus funds in starting new industries manufacturing dyes and chemicals.

Groups of cement, cotton and sugar mills in a large country like India had to establish factories for manufacturing the machinery required by members of their industries.

### **Fundamental Points Considered Before Making Choice of an Industry:**

*Finance:* If a man running a small factory, proposes to operate on a little larger scale, and manufacture articles like lanterns or ceiling fans requiring more capital than he himself can command, he would give up his independence and prefer to share his responsibility with a few of his friends and would request them to join him in a partnership. Unless provided otherwise by agreement, all the partners composing the firm will have fairly equal rights and they will have to work harmoniously.

But where the article, to be manufactured is a fairly complicated one to make and requires many component parts as in the case of oil engines or motor cars, the entrepreneur cannot depend merely on his friends. He must get the help of the larger public. Therefore, he has to handle the scheme with the help of some men of standing, through a joint stock company, which will raise capital by offering the shares in the company to the public.

This treatise will be dealing mostly with factories run on a fairly large scale and owned by joint stock companies.

As capital is the most important factor, the choice of the industry will have to be restricted within the range of articles that can be manufactured with the capital the company will be able to command.

### **Two types of Organisations:**

If the capital resources are limited, the company will generally choose an industry which is more of the type of an assembly industry, where there is no big manufacturing programme, and most of the components can be bought from others. The buildings and space required are also smaller. There is not much capital required to be locked up in raw materials, and the problems of organisation are simpler. The ceiling fan industry is of this type; the covers can be bought from a foundry, the stampings can be had from a bigger manufacturer who has specialised in making these, the wires required for armature winding can be imported or purchased from the market.

In England, where many factories specialise in making different parts of a cycle like wheels, chain, seats, tubes, bells, pump, etc., it is easier to have an assembly factory making cycles.

The other type of factory involves the processing of the raw materials and the manufacture of certain components within the factory itself. A selection even from this type of factory will depend on the capital one can command. A factory producing oil engines with less number of parts and components will require less capital than an automobile factory and a sugar factory, where the process is simple will require much less capital than a factory making chemicals like caustic soda or soda ash. The choice therefore will have to be made according to the capital resources available.

### **Scrutiny of Resources and Prospects of Producing the Proposed Item Profitably:**

The most important points to be considered before finalising a decision to manufacture a particular article are:



1. What will be the cost of production, which will include:
  - (a) Cost of raw materials.
  - (b) Labour.
  - (c) Power or fuel.
  - (d) Depreciation.
  - (e) Administrative Expenses.
  - (f) Taxes.
  - (g) Other expenses like advertisement, etc.
2. What price the article will fetch ?
3. What will be the total capital required for putting up plant, building and machinery?
4. What will be the working capital required for running the factory?
5. How many parts will have to be made in the factory, and how many can be purchased from reliable sub-contractors?
6. Who are the Competitors in the field and at what price they are selling?
7. What will be the volume of sales?

If the answers to the questions lead to the conclusion that the company can manufacture the article at a competitive price and sell adequate quantities of it at profit, then the promoter's friends can be approached with the scheme and with the proposal to form a joint stock company to undertake the manufacture of the article.

### **Modern Industry :**

Setting up any type of modern unit especially of the engineering industry, like making oil engines, automobiles and textile machinery require decision on processes, horse power capacity and minutest specifications of the several parts and components which should fit into the whole after they are manufactured for the final assembly into complete units. Many of the processes and components are covered by patents and cannot be used or manufactured without the consent of the people holding the patent rights.

*Foreign Collaboration:* The entrepreneur if he proposes to manufacture say, oil engines, will have to approach the foreigner to allow him to make his engines in the country. The foreigner, in his terms, may want certain part of the capital, and certain part of the profits or certain amount on the sale of the engines (generally known as royalty). He will have to accommodate the foreigner to his utmost capacity, because without foreign assistance or what is called collaboration, he will not be able to put up a factory for years.

Foreign collaboration, if it is on reasonable terms is not bad, because it will be beneficial to the country to pay the foreigner some part of the profits, but retain most of the money that would have gone to the foreign country if the complete engines, or other items, were imported. Besides the financial gains, there will be more employment in the country.

*Choice of Processes; Choice of Machines:*—The entrepreneur's problems do not end with the choice of the type of industry. The oil engine manufacturer, having decided in favour of horizontal type of engines, will next be faced with a bewildering choice of general-purpose machinery to choose from while selecting machines for manufacturing the oil engines. Some machines may be costlier, but may be economical in the long run because each might handle more than one operation or types of operations. The more complicated the articles the factory wants to produce, the more will be the varieties of processes and machinery offered, as in the case of railway engines, motor cars or heavy chemicals.

### **The Scheme for the Board:**

Therefore, if a factory is to be established on a large scale, serious attention will have to be paid not only to the details of the scheme for setting up a factory, but also to the choice of processes and machinery, because there will always be the danger that if the entrepreneur, who starts the factory earlier, does not pay serious attention to details, and is happy if he can only put up a factory, another, more experienced, industrialist might make a more thorough study and set up a factory, which can manufacture the same product, at a much cheaper price, by better processes and more suitable machinery.



The shrewd businessmen who are to form the new company's Board of Directors, will require for their scrutiny the scheme, completely worked out in detail, to find out whether every aspect has been taken care of. The company, therefore should draw up its scheme after taking into consideration the points briefly indicated in the next chapter.

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## CHAPTER III

### DETAILS OF THE SCHEME WORKED OUT WITHIN FINANCIAL RESOURCES COMMANDED

No prudent entrepreneur ventures to start a factory without a thorough study of the details of the scheme he proposes to work. An enduring industry can, like an enduring house, be built only if the foundations are sound. Few industries built on account of temporary advantages or short-lived fortuitous circumstances or launched on account of mere patriotic or sentimental grounds have survived. The history of industries is strewn with graves of industries set up in wrong places by wrong men, on wrong premises. When the Government gives Protection to industries the scope for starting new industries is no doubt increased, and if at the same time the Government is required to shut out imports, there is an unhealthy stimulus. When such conditions prevail in a country, it is time to be cautious and to see that the industrial development in the country proceeds, if a little slower but at least on sure grounds.

There is a curious and very interesting phenomenon in the industrial world: Industries beget industries: When new industrial establishments increase or more industries of the same type come into existence, they can support industrial units manufacturing machinery which can replace the old machinery obtained earlier from foreign countries. They also require spare parts to replace those parts of the machinery which get worn out more quickly; for instance, when India had only a few sugar mills, nobody could think of starting a factory or factories to manufacture sugar factory machinery in the country as the market for such machinery was very limited. With the large number of sugar factories that have now come into existence, in the country a new field has opened up for the manufacture of sugar mill machinery and spare parts.



An entrepreneur thinks of establishing a factory when he needs it as an ancillary for his existing industrial units, or because the advantages of starting a particular type of industrial concern have struck him. He then draws up a tentative scheme, with tentative calculations. If he is satisfied that he can, on the basis of the information he has obtained and the study he has made, produce a selected article in adequate quantities at a reasonable cost and can sell it at a price which will cover, not only the cost of materials, labour and other expenses, but also the depreciation on the machinery and will still leave sufficient profits to give satisfactory return to the people who will be investing their capital in the concern, he draws up the scheme in a scientific manner, to get it checked by others who have experience of running industries, or are experts, who can guide him on particular points regarding selecting of processes, choice of machinery, the total capital required and the cost of production etc.

The important points which will require the entrepreneur's attention while drawing up the scheme or putting it into effect are dealt with in this chapter.

#### **Location :**

The most serious thought has got to be given to the selection of the factory's location, which is almost inextricably bound up with transport. Of course, the best location is where the raw materials for the industry and the market for the product are near each other. In some cases, however, as for instance, a cement factory, the factory has got to be near the bulky raw materials. A sugar factory has got to be in the sugarcane growing area, where adequate supplies of sugarcane are available. The paper mills go near the source of their raw materials-grass and bamboo. Chemical industries depending on salt, cannot go far away from the supply of salt.

The shipbuilding industry has got to be on the seashore.

In some cases, the perishable nature of the raw materials, like fish or fruits, decides the location of the factory.

The site of a factory must be on the main line of a railway and should have access to a highway. An ideal situation is that where the factory has communication by land, sea, and air.

It is only the high-conversion industries like watch-making and making of precision instruments where the costs and volume of raw materials are very small compared to the value of the finished article, that the industry can be put up anywhere, preferably in the cities, where the climate is suitable and adequate skilled labour is available.

Transport, labour, climate and taxes are important factors to be considered, in their descending order, in fixing location. Though proximity to raw materials is absolutely necessary in case of cement and sugar factories, they must be built near a railway line if further costs of transporting the production—a handicap in competitive market—is to be avoided.

Where two or more kinds of basic materials go in the making of a product, the choice of location is determined by the place which gives the ultimate product at the minimum cost.

A refractory factory will run at a loss if it is expanded beyond the capacity of local supplies of clay, and more clay is sought to be brought from sources hundreds of miles away. This proves that even expansion of an existing factory requires thought.

If many factories making the same product are concentrated either in the eastern or southern parts of a big country it pays to start a new factory in the West or the North, if advantages in savings on account of transport or breakages outweigh other comparatively adverse factors.

*Water :* The most suitable site has sometimes got to be rejected for lack of adequate supply of water. Some industries like paper, rayon, require large quantities of water, and must therefore have large and uninterrupted sources of water supply. Even fairly large factories, if they are away from cities or towns, require a large supply of water, if not so much for their operations, at least for their own industrial population. Source of adequate and uninterrupted water supply is therefore an important point that cannot be over-looked.

*Power :* There is hardly any industry today which can do without electricity. The aluminium industry requires the largest quantity of electrical energy compared to other industries. Though



that may be an illustration of the highest voltage required, electricity is indispensable to all industries whether they are run as small cottage industries or as big factories. Break-downs in electric supply, even for a few minutes, will not only stop the working of a factory, but may cause heavy losses in the case of chemical factories, or glass furnaces, where the goods in process are likely to be spoiled by the failure of electric current. The power supply should be reliable and adequate.

*Fuel:* Most industries cannot do without boilers. They depend on them for their electric supply or special gases required for some of the processes. If the boilers are coal fired and the quantity of coal required is large, they must select a location where coal can be easily available regularly and in adequate quantities. Diesel oil is another source of power. If it is to be used, regular and adequate supply must be arranged.

*Raw Materials:* The term "Raw Materials" includes all tangible items that are used in the production of the finished article, and may even cover finished products of other industries. Soda Ash, is a raw material essential for making glass and fuel injection equipment, a necessary component of an oil engine, are the finished products of other industries. Generally speaking the predominant material is referred to as the raw material, cotton in case of a cotton mill.

Where the raw material is bulky as in the case of a cement factory, or perishable, like sugarcane, the factory has to be located near the supply of raw materials.

Mere presence of the raw material does not decide the location, even in the case of bulky raw materials – they must be available at reasonable cost, in adequate quantities over a number of years, and must be of the required quality.

A sugar mill, established in a place where only a restricted area can grow sugarcane, and that too of the type which gives comparatively poor percentage of recovery of sugar, will never succeed.

A coal or copper-mining company must get reports from very competent experts about the expected quality and quantity of the underground reserves.

Of all the industries the fish-canning industry has to be prepared to shift its factory if the fish change their habits after a few years. The profits must be large enough to bear the cost of shifting the factory.

Where finished products of other industries are to be used as components, care should be taken to select the products of a particular reliable company, which can supply the article in adequate quantities over a period of years.

A company depending entirely on foreign imports of a semi-finished product like brass or copper strips, wires or tubes, or finished products like gear-boxes or differentials for cars is likely to experience difficulty in securing supplies if the government of the foreign manufacturers refuses to allow exports for any reason, or its own government reduces import quotas on account of shortage of foreign exchange.

Factories manufacturing costly machinery are likely to suffer heavy losses if they omit to have their own foundries and decide to depend on other established foundries for their special castings.

As production becomes complex, the raw materials have to come from distant parts of the country or from many foreign countries. This point is well-illustrated in the case of a glass factory situated near Bombay, where it has the largest market, but for which sand has to come from Allahabad, coal from Bihar and Bengal and soda ash from East Africa.

In brief, the factory will have to be assured that it will have at the location a steady supply of raw materials at a competitive price assumed in the calculation of the cost of production.

If any of the raw materials or components are to be imported from foreign countries, the prospects of securing the Import Licences where there are restrictions on imports, as in India at present, will have to be definitely assured.

*Transport:* The transfer of goods from one place to another gives rise to two points for consideration (a) the means, and (b) the cost.



The means of transport include railways, motor-trucks, ships, aeroplanes and even pipe lines. It is not always possible to secure a location having all means of transport but the factory must have available at least two means of transport. A factory having access only to railway station, will suffer heavy losses if the railway, for special reasons like famine or war, refuses to book the goods for some time. Motor transport of finished products might not be possible for lack of good, direct roads connecting the place with important railway stations which might still be open for booking to big market centres.

Transportation is the life blood of industry. To keep the factories going, raw materials must move to the factories and the finished product must go out to the markets by the cheapest, quickest and most efficient mode of transport.

*Communications:* Transportation handles transfer of goods, while communications convey ideas and information. Post office, telephone, telegraph, radio are the principal means of communication, but runners, cycles, cars and railways are also used for conveying information.

Every factory must have the benefit of two or more means of communication to receive and transmit ordinary or urgent information.

*Climate:* Certain industries require certain types of climate as an additional help in their production, but apart from that, the climate of a place affects the output of the labour. Malaria-ridden parts may cause larger number of absentees. Places where the rainfall is very heavy, may give more sickness and depression, while a situation where the temperature rises high may impair efficiency. Bangalore and Poona are receiving preference on account of their bracing and equable climate.

*Effluent:* Paper and Chemical industries have to discharge large quantities of water containing chemicals and impurities. They must see that the site offers facilities for carrying away the effluent without causing harm to the public.

*Educational facilities:* It would be very wrong if a person, intending to put up a very large plant decided to put it up in a

small village in the interior of the country far away from any big city, only because he had large ancestral lands there. There will be no educational facilities there and he will not be able to get a choice of skilled workers or technical assistants. No technician or skilled labourer, worth his salt, would stay long in that out-of-the-way place, lose touch with technical developments and maintain another establishment in the city for his children's education.

*Social amenities:* Absence of social amenities like clubs, hotels, cinema theatres, etc., near the factory and lack of medical aid in the vicinity of the factory, make employment at the factory unattractive.

*Taxes:* Taxes would not intrude in the question of location if they were uniform all over the country. Some of the States and local bodies levy, queer or heavy taxes. Such States or localities should be avoided.

*Decision:* In fact, the decision of location is dependent on the best possible balance of favourable and unfavourable factors after working out the cost of production of the item at each of the various sites under consideration. In some cases the markets may be nearer but labour costs may be higher. In others labour may be cheaper but cost of bringing materials to site higher. In still others, local taxes might be so high as to discourage establishment of a factory.

After deciding the most important problem of location, the entrepreneur turns to other details like land, building, plant, machinery, capital required etc.

### Land:

An industrial unit must have large areas of land suitable for its purpose. Land is required not only for the factory buildings to be constructed immediately, but also for the administrative staff, labour and for amenities. There must always be spare land for expansion of the factory. The area that an industrial unit will require, therefore, depends on the circumstances of each unit, and if a huge concern like Tata Iron and Steel works or Chittaranjan Locomotive Factory is to be put up, it will require



land which will provide not only for the factory with an area of some square miles but will cover a township stretching over dozens of square miles. Land in, or near, the cities may be very costly and may be a big drag on the capital to be collected. Therefore, the entrepreneur selects land on the outskirts of a city, if not in the suburbs, where the land is cheaper. The cheapness of land, by itself, is not the only consideration.

*Clear and Marketable Title:* Of course, before proceeding to build a factory on a selected site, the promoters of the industrial concern have to see that they secure an absolutely clear and marketable title to the land if the land has not been acquired for the company by the State Government under the Land Acquisition Act.

### **Buildings and Roads:**

When a new factory is being built, the promoters and their executives are required to have a definite plan as to where they are going to have the factory buildings, the roads, the bungalows for the senior officers, quarters for junior officers and essential labour, and the structures for other essentials like reservoirs for water, electric sub-station, workshop etc. Some of these have to be provided immediately, and some later. The factory buildings should be so planned that the raw material should move forward through every subsequent process till it reaches the packing room and the despatch platform. Godowns should be provided for storing raw materials at one end and the finished products at the other, near the despatch platform. Space for components and stores required in the process, being provided at suitable places between the two ends. There should be enough room for expansion all along the line.

It often happens that the work is begun in the dry season and the necessity for pucca roads is not felt at that time; transport of materials from the main road or from the railway station becomes difficult at the outbreak of the monsoons. Even in the matter of construction of buildings, the roads must come first, to enable the materials to move smoothly and quickly to the desired sites.

The planner and his executives have to phase a programme for building very carefully, so that buildings are sufficiently ready by the time the consignments of machinery arrive. The planner himself should have the correct idea of the size of the machinery to be installed. Otherwise, he may find that the doors cannot take in the machinery, or the ceiling is kept so low that some of the machinery cannot be erected and worked within the low ceiling. Much valuable time and money is wasted in altering the buildings, and the machinery suffers by the unnecessary dumping in wrong places till the alterations are completed. It is no use having a programme if efforts are not made to stick to the schedule.

It is difficult to enumerate the various factors that have got to be taken into account in selecting a site for the bungalows and quarters for the labour. Having quarters for the labour beyond the compound enclosing the plant and machinery, is found more advantageous and safer, because labour occasionally becomes violent and tends to damage the machinery. It is always better to have a compound wall round the factory, as thefts are becoming more daring and more frequent. Attention paid to providing electric connections and wiring in proper places while the roads and buildings are under construction, is never wasted. Equally detailed attention has got to be paid to the bringing in of steam where steam is required. Attention paid to industrial hygiene at the time of construction of the buildings pays its own dividends, as proper light, air, ventilation, clean drinking water and other factors promote the health of the labour and increase their efficiency. Some of the machinery requires very solid foundations, and there should be no departure from the specifications laid down by the manufacturer for the foundation. Providing trolly-lines where bulky raw materials or bulky finished products are to be handled, accelerates the movement and often avoids spilling or breakage. Where the ultimate product is the result of many processes or an assembly of parts, the conveyors speed up the flow, reduce the labour and help in seeing that no component remains to be inserted in the individual items of production at the proper stage.



**Technique and Technical Staff :**

The number of experienced and qualified technical staff required in an industrial unit will depend upon the simple or complex nature of the ultimate product. A sugar mill, with its straightforward process, can be satisfied with a good chief chemist, competent mechanical engineer and an electrical engineer. But a motor car factory will require a host of first class technicians to look after drawing, designing, tooling, machine shop, forgeshop, electrical equipment, brakes and lubrication wings, besides a very competent production engineer to allot and co-ordinate production.

Failure to provide adequate competent staff leads to ultimate disaster.

It must be remembered that it takes the technical staff some time to reach the anticipated volume of production and attain the required standard of quality. The top technical staff is hardly to be blamed. The new machines have to gain their tempo; the steel or castings may not be of the required quality; the labour or skilled workers have not become accustomed to the quickness or alertness required of them and perhaps the inspection staff at various stages has not attained the efficiency required and defects are slurred over in the preliminary stages with the result that the item is rejected at a much later stage, when the defect can no longer pass muster.

Only competent persons, who can make decisions, without bias, should be allowed to tackle the technicians.

**Recruitment of Labour :**

New factories generally cannot afford to pick and choose in the recruitment of labour. Even then the best policy would be to engage labour known to or related to other older employees. In the first instance, practically all employees should be on probation so that shirkers, quarrelsome people, drunkards and the like can be got rid of without trouble. The labour, as a rule, is sensible and is able to appreciate the difficulties of the factory in the beginning, provided it is satisfied that as much as possible is being done for it, particularly in the matter of drinking water, sanitary arrangements, medical attention and shelter for taking meals. It

is possible to build up very good relations with the labour if the top executive is prepared to handle the grievances himself, by making each disgruntled person speak frankly about his particular grievance.

The ministers, in some of the States, want to give concessions to labour without weighing the consequences. One such minister, it is reported, wanted a new industrial concern, just started, to provide quarters for a very large part of the labour employed. It is not possible to have industrial development if such an absurd condition is imposed. Such amenities should come out of the profits of the company or out of subsidies from Government. The absurdity of such an order, it is said, was brought home to the minister who had forgotten that his State owned over 70% of the shares in the Company running the factory. The Company was not doing well and nobody would lend it money for the project of immediately building quarters for the labour. The directors of the company asked the State to put in more capital to enable them to comply with the minister's orders. The cabinet refused and the minister had to withdraw his order.

Where the atmosphere is charged with unrealistic ideal of the pattern of society, the entrepreneur will have to be prepared for shocks.

### Process to be Employed:

The entrepreneur, when he decides to set up a factory to manufacture a certain selected item, no doubt makes his calculations about the cost, basing it on certain data gathered about the process to be employed and the relative machinery required etc. But science is moving so fast that when he comes to brass tacks and starts negotiations for purchase of the machinery, he is faced with claims made by different manufacturers of machinery for their processes and their plants and machinery.

When his attention is drawn to one or more processes recently invented, he cannot stick to his old plans without more detailed study of the comparative merits of each new process and its suitability to his circumstances.



### Selecting of Machinery :

Securing the right type of machinery becomes very important particularly when the industrial concern has got to be started on a large scale and is likely to have to face severe competition. In selecting machinery three important points have to be kept in view – the price, the output of the machinery and the quality of the product it will turn out. The machinery should be capable of turning out goods in such large quantities that the profit on the output will cover all expenses which are mounting up. In short, machinery purchased should be adequate to make the concern an economic unit. If for lack of funds the promoter purchased, say in the case of textile machinery, an equipment for five thousand spindles only, or in the case of a sugar factory, a unit which can crush only three hundred tons of sugarcane per day, the output will not bring sufficient profits to the company and the company will soon have to be wound up.

The margin of profit on the sale of individual items of production is small. Unless the volume of production is large enough, the margin does not cover the depreciation of machinery, interest on capital employed and the administrative expenses.

The machinery should be capable of producing goods of the required quality. Most available machines will produce an article, but the concern which purchases up-to-date machinery eliminating many processes and giving a larger output per hour, will cut down its costs. Take the simple case of hurricane lanterns, manufactured by a very small concern with some metal pressing equipment and a large number of labourers soldering many parts together. This company cannot stand competition with another company using automatic machinery, carrying out several operations in one machine, turning out many parts with accurate precision and eliminating many processes of soldering. Similar will be the case with a fertilizer factory which orders antiquated type of machinery if another orders up-to-date machinery, with new processes, which can give larger production at less cost.

The total machinery installed in a factory is generally referred to as a “ plant ”. The nature of machinery required differs with

the type of the product to be manufactured. For instance it is easy to choose a machinery where the process is simple, as in the case of sugar or cement where you put the raw material at one end and get the finished product at the other. When well-known and established companies, manufacturing or selling complete sets of sugar mill machinery, are offering complete plants, it is easier to get the information about the efficiency of the complete equipment offered by each of them and make the choice.

It is more complicated in engineering industries like automobile or machine tools, textile machinery etc. where the ultimate product is made up of a number of components. The factory has to decide what components it will make, and what it will purchase from others. It may be offered machinery which will reduce her dependence on outsiders for some components, but the output required for the factories own use being small, the machine may not have more than 200 hour's work in a year. Finance permitting, the balance of advantage in securing required production in time will decide the choice. An industrialist, who has experience of running industries can generally select suitable and up-to-date machinery for the plant he wants to set up, but a trader, who wants to enter industry for the first time and lacks the experience and is not careful to consult proper persons and take their advice, may make a fool of himself.

A new paper mill, which recently installed machinery worth over Rs. 2 crores, had to order the machinery from 24 leading manufacturers in England, Scotland, Austria, Germany and Sweeden, to get the most up-to-date and most efficient machinery for each department.

The world can, at a price, supply machinery which can give gigantic production. Production on that scale, no doubt, reduces the cost of the product to a certain extent. But this giant cannot be handled by pigmies in stature and finance. The giants no doubt require very large finances for raw materials and finished products but the practical difficulties they create sometimes ruin the concern. The production is so large that if the production cannot be sold as fast as it is manufactured, and if the machine continues to work,



the production will require such enormous space for storing, that further production will have to be stopped – a contingency which every factory wants to avoid.

### **What is Deferred Payments System ?**

Many under-developed countries and also many industrially advanced countries, desirous of putting up new industries or reconstructing established industries, do not command enough foreign exchange resources to pay for the machinery to be imported from other countries and have imposed licencing of imports. Nationals of the countries where such restrictions on imports prevail, for example India at present, must secure import licences from the government before finally concluding the purchases. Sometimes when large payments for machinery are involved the Government imposes certain conditions while granting the licence. One of them often stipulates that the purchaser of machinery will secure from the foreign sellers the concession of “Deferred Payments” i. e. he will be allowed to pay a portion of the price on delivery and the balance in instalments, spread over 2, 3 or more years.

### **Guarantee of Performance :**

In the case of projects requiring an expenditure of more than Rs. 25 lacs on machinery, it is better to take the advice of consulting engineers and industrial consultants, who can weigh the various aspects of the scheme and can recommend suitable processes and up-to-date machinery and make the suppliers of machinery guarantee the output. It is fatal to work on vague ideas of what machinery is required and then go on placing orders with manufacturers in different countries, because the prices are lowest or the commission or rabate is the highest. Performance of such machinery, ordered haphazardly from different people, can rarely be smooth and in case of breakdown or continued low production, no responsibility attaches to any particular supplier. For complicated machinery particularly for those industries, which have not existed in the country and where there is complete lack of people with the know-how of the industry, it is always better to get the assistance of the suppliers or the industrial consultants to secure technical men on short-term contracts to run

the plant for the first three or four years. It is also fatal to be vain about one's knowledge because one has run a small factory and make changes in the designs given by experts. In the case of machinery it is important to ensure that full payment is not made, till the entire machinery to be supplied by the makers is at the site and is working satisfactorily and giving guaranteed production.

The discovery that certain essential parts have not come or may come later might be a misfortune, but its effects on the scheme are crippling, because though everything is ready, the factory cannot go into production and has to keep on paying the staff and labour collected.

### Second hand machinery :

During the last war when new machinery was not easily available and in later years, when the prices were very high or deliveries of complete plants were quoted after one or two years, there was a tendency to purchase second hand machinery.

Many factory owners, in India, are at present in search of unused or second hand machinery, because of the unavailability due to restrictions on imports of new machinery.

The life of second hand machinery is always shorter than that of new machinery. The designs are also of the old type.

Old machinery can often give desired service for some time—the period and usefulness depending on the age and type of the machine and the work expected of it.

Though it might be advantageous to use few second hand machines in a factory, it is not advisable to purchase a second hand plant for a factory like a sugar mill or a cotton mill without expert advice. The sellers might be selling it because it is inefficient or defective.

The two tests to be applied are:—

(i) Will the second hand machinery earn enough large profits to enable the factory to write off the cost in two or three years.

(ii) Is the machinery absolutely necessary for getting larger production or for a particularly important operation.



It must be remembered that it is difficult to persuade a lender to give loans against second hand machinery.

### **Letters of Credit :**

Most good manufacturers producing specialized machinery would not undertake the manufacture of the machinery unless a letter of credit was opened in their favour through a big bank. The terms might all be in favour of the manufacturers unless the purchaser is careful to get the terms examined by bankers or industrialists, who can point out the unfavourable aspects and get them suitably amended to protect the purchaser's interest also.

### **Foreign Exchange Rates :**

Depreciation of the currency of the importer's country, in terms of the currencies of the countries supplying machinery, has also an important bearing on assessing the cost of the machinery. It is therefore, necessary to buy forward the supplier currency from the bankers at the time of opening the letter of credit. If the currency depreciates by about 20% the machinery expected to cost Rs. 50,00,000 will require about Rs. 62,50,000.

### **Transport of Machinery :**

The history made by the "Machine Glaze Cylinder" of a large paper mill, will for long, remind the entrepreneurs, how far they must see and arrange about the transport of unusually large parts of the plant.

The cylinder used for giving one side glazing to the paper like Kraft and Manila, was  $14\frac{1}{2}$  feet in diameter and weighed fifty tons in one piece.

The wagons then obtainable at the broad guage goods yard at the port of entry into the country, it is reported, were just not equipped to handle such a large and heavy piece. A suitable wagon was secured after some days.

A special wagon, had to be ordered to be made for the metre gauge railway line from the last station on the broad gauge.

It took several days for the cylinder to make its leisurely way from the port to the last station on the broad gauge and further

journey on the metre section to the station nearest to the factory site which was a dozen miles away.

There were only kutcha roads between the station and the factory and even jeeps found it difficult to negotiate them. The problem of moving the leviathan bogged every possible device. It was only the help of the Army and their heavy trailer that made it possible for the heavy piece of machinery to reach the destination.

### Erection of Machinery :

It might not be difficult to erect the machinery with which many people in the country are familiar, but where the machinery is costly, complicated and for a new type of industry, or for a chemical factory with a new process, it is necessary to stipulate that the suppliers of machinery will erect the machinery at its site in the factory.

### Power :

A big factory set up on the assurance of a State Government that they would be able to supply adequate uninterrupted electric current of the required voltage, had to, it is said, suffer heavy losses on account of the failure of the State Government to install new and efficient machinery in the generating station. The voltage was sometimes so low that the factory had to stop working. The company, having suffered losses in continuing to run the factory intermittently, whenever the current was available, had to invest a large amount in putting up its own generating unit, to be independent of the State Government's supply.

The State Government, having lost the largest consumer of electric energy to be generated by that unit, had to dismantle the unit and to take it elsewhere to serve another set of unfortunate people. The State Governments are reported to have tried to control electric supply companies and often failed to take a serious comprehensive and businesslike view of their responsibility and have starved important sections of their territories of electric



supply, where a large number of industries could easily have been established. A region, which had to go without additional connections of electricity in the immediate post-war years, is pointed out as a glaring instance. History will give its verdict as to who was really at fault.

It is said that the Government often charges such high rates for electricity that industrial establishments sometimes find that they can generate their own electricity much cheaper. The cost to be paid for the electric supply to be obtained will have to be carefully examined. In fact, it is not prudent to start a factory at any place until electric supply is available and at a reasonable price.

#### **Water:**

Adequate supply of water is essential for every factory. No construction should be started until the supply of water is actually available. Reports say, some factories which had selected certain sites depending on Government schemes had to choose other locations elsewhere because they learnt that the scheme of supplying water was not likely to be completed for some years.

#### **Communications:**

If there is no existing Post and Telegraphic office it is risky to depend on mere promises from the Government departments.

#### **Transport:**

The Railways take their own time in supplying the sidings promised. It is harder to get a special railway station started.

These delays and difficulties must be taken into consideration before the final decision on commencing the construction of the factory is taken.

#### **Raw Materials:**

Where the location is decided on the possibility of securing raw material from the surrounding areas, and the source of the raw materials available is controlled by one or two persons, it

would be unwise not to have definite contracts with the owners to supply it at a reasonable price and in named quantities as and when required.

Where the raw material is the largest part of the cost of production, the ability to make profit depends on the skill in purchasing the raw material at the lowest price possible.

Where raw materials have to come from some distance, the factory must make sure that the cheapest transport will be always available.

The quality of the raw material is also a very important point. Serious consequences follow if the inward flow is not carefully regulated. A story is going round of a sugar mill company, which established, in one of the best sugar-cane growing area, a factory with a crushing capacity of 700 tons of sugar-cane per day, but relying on the availability of plentiful supplies of cane, did not arrange with the farmers to bring their produce on specified dates. When the mill started working hundreds of farmers brought sugar-cane to the mill. The mill purchased what it could crush in a week but refused to buy from the later arrivals. The disappointed farmers cursed, went back and turned it into jaggery, and made it widely known that it was no use taking sugar-cane to the mill. The mill could not get enough cane during the season and suffered heavy loss. It could not later over-come the antagonism of the neighbouring farmers and eventually closed down.

Providing ample and safe storage accommodation for the raw materials and stores, unless attended to in time, causes heavy losses due to deterioration, fire and theft.

### **Insurance :**

There is tendency to avoid insuring the assets of a factory altogether, or insuring them for an amount less than the current value of the assets. This is wrong. Effecting insurance is the best and cheapest way to transfer the risk for a small payment, called premium, to insurance companies.



Many a business has been ruined because it did not carry insurance cover when a disastrous fire had occurred.

### Cost of Production :

The essence of any scheme for manufacturing a particular product is to arrive at, what the approximate cost of making it would be, in the circumstances of the factory. If the item is already being produced in the country it might be possible to get reliable guidance from men in the line, or from government reports, if costs are discussed by a commission or committees. In case of a new line in general engineering, it is better to dismantle completely a specimen, estimate the cost of making or purchasing of each of the parts. Since the fortune of the company depends on this vital information, its correctness should be checked and re-checked before it is finally accepted.

It should be borne in mind that the calculations would be upset if the plant does not give the rated output for factory or the costs under some of the heads of expenditure for manufacturing prove higher than the estimate.

If prices of everything to be purchased go up, and prices realized also correspondingly move up, the effects of the first variations will be neutralized.

Frequent comparison between the estimated and the actuals on the expenditure side will reveal aberrations quicker, and can be, if possible, remedied at the earliest.

If a cotton mill is established on the calculation that its 20,000 spindles will each produce  $5\frac{1}{2}$  ozs. of yarn of particular count, per shift, say, at a cost of say 22 nP. per oz., and the spindles actually produce  $4\frac{1}{4}$  ozs., and the costs actually amount to 30 nP. per oz., the calculations were wrong or some factors changed for the worse. Unless something is done quickly to regain the balance, the initial wrong calculations are going to bring about the ruin.

**Capital required for the company :**

How much capital the company must collect to be able to run the factory comfortably, is a question which every company must tackle seriously, taking into consideration what amount it will be required to spend on fixed assets like land, building, plant and machinery and how much additional money it will require as working capital for running the factory.

The price paid for the land is generally a very small fraction of the total costs of fixed assets and can be fairly accurately estimated if one is prepared to pay the real value of the land.

The cost of buildings can be easily estimated in ordinary times.

The aggregate amount that they will be required to spend on the plant and machinery can be easily ascertained if most of the plant is supplied by one or two manufacturers (as in the case of a sugar factory), who are willing to quote tentative prices. But where many different manufacturers from different countries are going to supply the machinery for the separate departments, it is a complicated business. No one would know the approximate cost until firm quotations are received from all.

Special or rare machines which have to be made to order, take months to be ready. The manufacturers of such machinery generally do not quote a fixed price as they want to protect themselves against wide fluctuations in their costs during the long period that must elapse between accepting the order and delivering the machinery.

A liberal provision should be made for the higher price that might have to be paid, on account of the "Escalator Clause."

It should also be borne in mind that as machinery is subject to customs duty which the Government might raise at any time. The cost will then correspondingly go up. The working capital necessary for the running of the factory will also have to be carefully calculated.



The estimate of the capital required may ultimately emerge some-what as follows:

### Requirements of Capital:

	Rs.	Rs.	Rs.
1. Land.		3,00,000/-	
2. Buildings.		10,00,000/-	
3. Machinery.		<u>60,00,000/-</u>	73,00,000/-
Raw materials value	30,00,000/-		
*Less Bank advance upto 75% of the value.	<u>22,50,000/-</u>	7,50,000/-	
Finished Products.	10,00,000/-		
**Less Bank Advance upto 75% of the value.	<u>7,50,000/-</u>	2,50,000/-	
Stocks in process. } Banks do not		4,00,000/-	
Stores and Spares. } advance against		5,00,000/-	
Wages.		5,00,000/-	
Other expenses.		2,00,000/-	
Contingencies.		<u>1,00,000/-</u>	27,00,000/-
			<u>1,00,00,000/-</u>

The company must have a paid-up capital of Rupees one crore.

\*Bank will advance upto 75 % of the value of the stock of the raw material. In this case Rs. 22,50,000. Therefore, the company will not be required to find money for the full value but only upto 25 % of the value of the goods i.e. Rs. 7,50,000.

\*\*Bank will advance upto 75 % of the value of the stock of finished products. In this case Rs. 7,50,000. Therefore, the company will not be required to find money for the full value but only upto 25 % of the value of the goods i.e. Rs. 2,50,000.

### Various factors increase costs of the Project:

The following extract from a short history of a new big factory, which recently started production, will give some idea as to how the cost of a project sometimes exceeds the original estimate and the normal variations expected. "A word, in explanation, of

the increase in capital outlay. There are several reasons for this huge increase. First the layout was changed (on the insistence of the experts) so as to have an easy expansion from 60 to 90 tons per day. The quotations of machinery were received in 1955 and the orders were placed in 1956. By this time the prices had already risen because of increase in cost of labour and material. Again there was an increase in import duty and the excise duties on cement and steel in the 1957 budget. The machinery suppliers had also increased their prices according to the escalator clause. Above all the delay of about six months in the completion of the project resulted in an enormous addition to the capital outlay”.

### **Working Capital from Banks:**

Industrial concerns like the cotton mill requiring large funds—sometimes larger than their paid-up capitals find it more profitable to take financial assistance from commercial banks than to raise large share capital. This is because the banks willingly advance against easily saleable raw materials like cotton and readily disposable finished products like cotton yarn and piece goods upto 70/75% of the market value of both. But if the factory is making flash-light batteries, the banks would like to avoid making advances against the special kind of zinc sheets which only battery-making establishments can use and against batteries which deteriorate with time and would be unsaleable if the company failed to have rapid turnover. The banks will not advance against stocks in process, stores and spares.

Few large manufacturing concerns can go on without bank's assistance. Every promoter must therefore, discuss his requirements of finance with his banker, disclose the nature of the raw material and finished products and try to arrive at an arrangement to get enough accommodation from the bank.

A company has to have enough surplus funds to run the factory after paying for the land, building, plant and machinery.

A company is said to be under-capitalized when it has not got enough capital either for purchasing the fixed assets or for the running.



The positions of two cotton mills each with 25,000 spindles and 500 looms, one of which had collected paid-up capital of Rs. 1,25,00,000 and the other had been able to raise only Rs. 1,10,00,000, illustrate the difficulties of under capitalization:

A Mill Scheme.		B Mill Scheme.	
	Rs.	Rs.	Rs.
Land.		3,00,000	3,00,000
Building.		10,00,000	10,00,000
Machinery.		81,00,000	81,00,000
Raw Materials (Cotton Value)	40,00,000		
Less Bank Advance.	<u>30,00,000</u>	10,00,000	
Yarn and Cloth Value:	16,00,000		
Less Bank Advance.	<u>12,00,000</u>	4,00,000	
Stock in process.		5,00,000	5,00,000
Labour.		4,00,000	4,00,000
Stores and spares.		5,00,000	5,00,000
Sundry.		2,00,000	2,00,000
Contingencies.		<u>1,00,000</u>	
		1,25,00,000	1,10,00,000

The mill "B" has not got funds to deposit the margin (Rs. 14,00,000/-) to get advances from the bank and has no reserves for contingencies. It is under capitalized.

### Taxes:

Statutes of most countries invest many authorities with power to collect taxes on many things at various rates, but it seems it is nobody's business to study the total incidence and correct the bad effects. A factory has to pay a purchase tax when it purchases raw materials, it is subjected to octroi when it brings in the goods to the factory. Another tax-gatherer comes around demanding surcharge on the electricity used for processing the goods. It cannot take out the goods without paying the excise duty, and is further mulcted for sales-tax when it sells the goods. Of course, this list is not exhaustive because very often it is not possible for the factory owner to know which authorities will be added, any

time, to exact their levies from him. He must be prepared for further demands called by more polite names like 'Cess' or inspired by benevolent objects like "Employers State Insurance".

Since the rate of the levies is often left to the sweet will of the authorities, the rates vary in different States, in different municipalities and with other authorities. An entrepreneur should avoid States and places where unreasonably heavy taxes are levied.

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## CHAPTER IV

### FORMATION AND RUNNING OF A JOINT STOCK COMPANY

#### Formation of Public Limited Companies :

Any seven or more persons, associated for any lawful purpose may, by subscribing their names to a memorandum of association, form a Joint Stock Company with limited liability and get themselves incorporated with the Registrar of Joint Stock Companies of the State in which the company will have its registered office.

Before the Registrar accepts any company for registration he must have a Memorandum of Association of the Company and Articles of Association of the company and agreements if any, entered into or which the company proposes to enter into, with its managing agents or secretaries and treasurers. If the company does not accept Table—A, containing the standard Articles of Association given in the Indian Companies' Act, it must say so and must prepare its own articles of associations.

The Memorandum of Association must contain the following particulars :

1. The name of the company with 'Limited' as the last word in its name.
2. The State in which the registered office of the Company is to be situated.
3. The objects for which the company is established and the State or States to whose territories the objects extend.
4. The statement that the liability of the members is limited.
5. The amount of share capital with which the company proposes to be registered and
6. The division of the shares capital into shares of fixed amount.

The company will also have to lodge with the Registrar a Prospectus if they want to invite the public to subscribe to its shares. It can file only a statement in lieu of prospectus if no invitation is held out.

In India, the Indian Companies Act passed in 1956 to replace the old Act, is a voluminous and complicated piece of legislation. Since it was passed recently there are no Court decisions to clarify many points, which are not clear. Most companies, therefore, entrust the drafting of the Memorandum of Association, Articles of Association and the Prospectus to experienced firm of lawyers or chartered accountants whose advice and guidance always proves very valuable.

By the Memorandum of Association the company must take powers to engage in all relative activities and also many other activities which it may undertake, because if the company wants to undertake any new business later on and, it is not permitted by the Memorandum of Association, the company will have to approach the High Court to have the Memorandum of Association amended or changed, to cover the new activities.

This is the reason why in the Memorandum of Association of many companies the objects named are almost fantastically wide and varied. A company formed for the purposes of manufacture may have power to engage in agricultural pursuits.

If the company wants to issue only ordinary shares it is a simple matter. But if it proposes to issue cumulative preference shares redeemable after say, 10 or 15 years, it must take into account, the interest it will have to pay on the preference shares from the date it receives the money. This interest, if unpaid, will go on accumulating during the years when the company will not have enough profits. The interest on cumulative preference shares is to be paid cumulatively, i. e. if the company cannot pay the interest for some years, it will have to pay the arrears of interest as soon as it has adequate profits. No interest can be paid out of capital without the permission of the Government of India.

Companies therefore, generally do not issue cumulative preference shares in the beginning. If the company estimates that its total requirements of capital will be say Rs. 50 lacs, it will offer to the public 50,000 shares of Rs. 100/- each, or 5,000 shares of Rs. 1,000/- or multiple of any sum fixed as the face value of the shares.



If all the preliminary formalities are complied with, the Registrar of Joint Stock Companies will on payment of the usual fee, grant a Certificate of Incorporation. This certificate will only show that the company has been properly registered, and can proceed to collect the share capital from the public. But before the Registrar issues the Certificate of Incorporation, if the capital of the Company is more than 5 lacs, he will require the company to produce the permission from the Controller of Capital Issues, to offer shares to the public for the amount, mentioned in the Memorandum of Association, to be paid either on application, or by instalments.

Before the company approaches the public it must make an accurate estimate of the response it expects from the public, because it will have to say, in its prospectus, what is the minimum amount, which in the opinion of the Board of Directors must be raised to provide for the matters specified in Clause 5 of Schedule II of the Act. Unless this amount is collected, the company will not get the Certificate to Commence Business, which is absolutely necessary before the company can deal in any way with the funds collected by way of share capital.

The promoters of the company have to be very careful at the time of initially complying with the requirements of the Registrar of Joint Stock Companies. The prospectus must be carefully drawn up to comply with all the provisions of the Indian Companies Act, disclosing all the information required and avoiding giving any misleading information. Sections 55 to 68 will give some idea of the details required to be given in a prospectus.

Main headings in a prospectus recently issued by one of the big companies floated by experienced industrialists are reproduced below.

“Consent of the Central Government has been obtained to this issue, by an order of which a complete copy is open to public inspection at the Head Office of the company. It must be distinctly understood that in giving this consent the Government of India do not take any responsibility for the financial soundness of any schemes or for the correctness of any of the statements made or opinions expressed with regard to them”.

“ A Licence has been obtained from the Central Government for the establishment of this new Industrial undertaking of which a copy is open to public inspection at the Head Office of the Company. It must be distinctly understood that in granting this Licence the Government of India do not take any responsibility for the financial soundness of this undertaking or for the correctness of any of the statements made or opinions expressed in regard to it ”.

A copy of this Prospectus has been duly filed with the Registrar of Companies, Bombay.

The subscription list will open on 10th September 1955 and will close on 20th September 1955 or earlier at the discretion of the Directors.

Prospectus :  
of

The

Ltd.

Authorised Capital :

Issued Capital :

Underwriters :

Rights of Cumulative Preference Shares :

Directors :

Bankers :

Brokers :

Legal Advisers :

Auditors :

Registered Office :

Objects and Prospects :

Capital Outlay :

Estimate of Profits.

Directors' Interest :

Preliminary Expenses :

Brokerage :

Contracts :

Directors' qualification and remuneration :

Restrictions on voting and transfer of shares :

Borrowing Powers :

Auditors' Report.

Voting Rights.

Applications for Shares:



As regards the capital the public is to be invited to subscribe, the company must make a very liberal estimate, to cover all its requirements of the cost of land, building, plant, machinery and the working capital required for raw materials, finished products, stores, spares, wages etc. If the company does not estimate its requirements correctly, and later finds that the capital collected is not sufficient for its requirements, it will not be able to put its scheme into operation and a lot of money will be wasted.

The sanction of the Controller of Capital Issues is also required if a company wants to borrow money by issuing Debentures or by creating any kind of mortgage or charge on its fixed assets.

### Technique of Collecting Capital :

A few companies can expect to get from the promoters' friends the entire capital required by the company. Major part of the capital of a big company comes from thousands of people willing to take shares in the new company. Some apply for 5 or 10 shares, some for hundreds and some few for thousands.

But the response depends on the standing and integrity of the directors and the prospects of the scheme put forward. Advertisements placed in leading newspapers, with full prospectus, make the offer of shares known to millions of people and the few thousands with money apply for shares.

But all those wanting to respond to the offer cannot go to the company's office hundreds of miles away. Facilities must be offered to them to send their applications through a number of banks covering many places in the country. The Banks charge a small commission for the service.

If the directors command respect, the prospects of the company are excellent and the public response is expected to be very good, a broker or a financial institution or both jointly will, if approached agree to underwrite the issue *i.e.* they will undertake to take up themselves or cause to be taken up by others, that portion of the total, number of shares underwritten, which the public will not subscribe to. This they will do for a small commission on the total amount underwritten.

### Allotment of Shares:

When a company invites applications for shares, it either receives applications for more number of shares i. e. if they offer 50,000 shares people apply for 70,000 shares, or they receive applications for less number of shares i. e. if they offer 50,000 shares the public applies only for 45,000 shares. When a company offers 50,000 shares and receives applications for 70,000 shares it will actually allot 50,000 shares and refund to the applicants the money received for 20,000 extra shares, forwarding Allotment Letters for 50,000 shares allotted to them. If the applications are for less number of shares, all those who have applied for shares will receive full allotment i. e. they will be allotted the number of shares applied for by them. They will get Letters of Allotment for the actual number of shares applied for by them.

### Interlocking:

When Company 'A' takes shares in Company 'B' and the latter takes shares in Company 'C'. All the three companies A, B and C are said to be interlocked. So long as these transactions have been done to start subsidiary companies to manufacture certain items required by the parent company A or to utilise a large part of the production of company A there is nothing objectionable. For instance Tata Iron & Steel Company Ltd., took shares in Kumardhubi Fireclay and Silica Works Ltd., which supplied them fire bricks or in Tinsplate Company of India (Private) Ltd., which used their steel sheets.

*Advantages of subsidiary companies:* If properly and honestly worked the system of having subsidiary companies, has certain advantages.

1. The parent company can lay down the general policy and leave the subsidiaries to pursue the business policies as shaped by local conditions, requirements and the decisions of the subsidiary companies' directors.
2. Separate accounts can be kept to give a clearer picture of the profit and loss of the separate business handled by the subsidiaries. The local management of the



subsidiary companies can be expected to deal efficiently and properly with their requirements of working capital and trading reserves.

This system of interlocking gives to unscrupulous people, facilities for manipulation of inter-company transactions with the intention of concealing the true state of affairs.

### **Running of the Joint Stock Company:**

A joint stock company can run smoothly only if it observes all the provisions of the Indian Companies Act (No. 1 of 1956). It must engage a competent qualified Secretary to ensure that all returns in terms of the Act are promptly submitted, all notices are sent out in time, properly worded, all meetings of directors and shareholders are properly and punctually called, all required statements are displayed, all charges are immediately registered and to see that every precaution is taken to avoid breach of any provision of the Act.

It must also appoint an Accountant to see that proper books of account, as required by law, are maintained, particularly in respect to :—

- (a) all sums of money received and expended by the company and the matters in respect of which the receipt and expenditure take place,
- (b) all sales and purchases of goods by the company and,
- (c) the assets and liabilities of the company.

Most of the big factories, in India are also required to have a Labour Officer to cope with the recent labour legislation.

### **What a Financial Institution would like to examine:**

Before a financial institution agrees to deal with a joint stock company, it must satisfy itself that :—

1. The company holds the Certificate of the Incorporation and the Certificate to Commence Business.
2. The company's Memorandum of Association permits it to handle the type of business the company proposes to undertake.

3. The copy of the Article of Association is authenticated as being up-to-date and that articles are well drafted and clearly show who are authorised to borrow on behalf of the company and if there are any restrictions on its borrowing powers. Some articles place restriction on the total borrowings by a company.
4. The total borrowing of the company (besides temporary borrowing from the company's bankers in the ordinary course of business) does not exceed the aggregate of the paid up capital and reserves (Section 293 of the Companies Act).
5. The company is publishing its balance-sheets punctually.
6. The affairs of the company are regularly audited.
7. The register of charges is maintained carefully and is kept up-to-date.

It would appear that a company's power to obtain temporary loans from its banker in the ordinary course is not restricted. But the lender will see that provisions of section 293 of the Indian Companies Act, 1956 particularly Clause (1)(d) of sub-section 1 are complied with. Section 293 (1) (d) enjoins more or less as follows:

The Board of Directors of a public company shall not, except with the consent of the general body of share-holders in a general meeting, borrow moneys after the commencement of this act, where the moneys to be borrowed, together with the moneys already borrowed by the company, (apart from temporary loans obtained from the company's bankers in the ordinary course of business) will not exceed the aggregate paid up capital of the company and its free reserves, that is to say, reserves not set apart for any specific purposes.

If the company wants to borrow against its fixed assets while the Capital Issues (Control) Act is in force, the lender will satisfy himself that the sanction for the same has been obtained by the company from the Controller of Capital Issues.

### **Managing Agents :**

Managing Agents are firms or companies, which specialise in promoting and managing industrial concerns.



The managing agency system, as it is known in India is unique. It developed out of political, economic and industrial circumstances. The East India Company disappeared in 1858, when Britain had started reaping the benefits of the Industrial Revolution and was in a position to export capital. The British trading houses in India were in a position to secure British capital and start industries in India.

There was then in India no investing class or capital markets, the managing agents were, with their foresights, selecting the industries to be started, providing finance for the industries and running them in face of all the difficulties regarding transport, communication and technical skill.

Since the Managing Agents, which were generally firms of standing and experience, were providing most of the finance and the people in Britain, who backed them, were trusting them with the money and the management of the industries, they had a free hand in managing the industries started by them. It must be said to the credit of the British Managing Agency houses that most of them enjoyed unimpeachable credit and standing.

The cotton trade boom in India, which followed the Civil War in America in the sixties of the last century and enriched many people in Bombay and Ahmedabad, was responsible for the beginning of the India managing agency houses mostly handling Cotton Textile Industry in Bombay and Ahmedabad.

Later when the stock exchanges began to function and the managing agents' share in the capital of the company became smaller, no attempts were made to curtail their powers or their freedom to manage the affairs of the companies. Their integrity was unquestioned, management efficient, industry tireless and credit almost limitless. There were, therefore, few complaints against the system of managing agency before World War I.

During the inter-War years, several abuses crept into the system, which were aggravated by the circumstances in which business was carried on during World War II and the general decline of standards that followed.

The system which recognises the managing agents and gives them larger powers-sometimes almost equal to those enjoyed by the Board of Directors - is suited to underdeveloped countries trying to promote industrial development, because it offers security, for many years, to the entrepreneurs who started the industry, and makes for efficient management untrammelled by petty restrictions by the Board of Directors.

The Managing Agents, who divert to themselves and their relations and friends, the profits which should really go to the shareholders, are cheats and must be punished.

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## CHAPTER V

### THE SCHEME IN OPERATION

#### **Management of Factory a Fascinating Occupation :**

The management of a factory is a very fascinating occupation. It not only satisfies the artistic feeling in man in having produced something beautiful and useful from plates of steel or heaps of cotton, but offers large scope of genius in the matter of reducing labour by tools and gadgets, accelerating production by better layouts and quicker movements, and welding together a number of people of different temperaments into a team organised to give the best according to each one's bent.

The financial side claims equal attention with the production side and calls for alertness in avoiding leakages and waste and ingenuity in reclaiming from waste.

India has the following types of industries – a large variety.

1. Iron and Steel —
  - (a) Finished steel ( main producers )
  - (b) Pig Iron for foundries.
2. Structural Fabrication.
3. Heavy Foundry-cum-Forge Shops :
  - (a) Steel Foundry.
  - (b) Forging Shops.
  - (c) Cast Iron Foundries.
4. Ferro-Manganese.
5. Aluminium.
6. Locomotives.
7. Automobiles.
8. Heavy Chemicals.
  - (a) Sulphuric Acid.
  - (b) Soda ash.
  - (c) Caustic Soda.

9. Fertilizers.
  - (a) Nitrogenous (Fixed Nitrogen).
  - (b) Phosphatic, as  $P_2 O_5$ .
10. Ship Building.
11. Cement.
12. Refractories.
13. Petroleum Refining.
14. Paper and Paper Board.
15. Newsprint.
16. Rayon.
  - (a) Rayon Filament.
  - (b) Staple fibre.
  - (c) Chemical Pulp.
17. Diesel Engines.
18. Bicycles.
19. Electric Motors.
20. A.C.S.R. Conductors.

No one book can deal with the details of organisation in so many industries. There must be separate treatises by experienced persons to deal with the problems of production and management of each industry.

An attempt is made in the following few pages to outline only the fundamental principles of factory organization and management.

### Policy :

A factory must first decide its policy, and the programme of production must carry out the policy. It should first be settled what article the Company is going to produce and of what quality. Though the quality should be of high order, it need not be of highest order, unless the buyer so specifies. Japan made the best crockery for American markets and also cheap quality to be sold in Asian countries. If the factory is producing only one item it will endeavour to have the largest production of adequate quality of that item.



There is temptation for engineering industry, where most of the machinery can do many jobs, to try to switch over to another line or to add a new line when the sales of the original product are sluggish.

That is not the time to discontinue the production of the original article. It is a warning to probe deeper to locate the faults, if any. If the sales are lower due to economic reasons like failure of crops, the factory must mark time. If sales have gone down due to the competitors selling similar article at lower prices, inquiry will reveal that the competitors were selling very inferior quality goods and many people were buying them only because they were cheaper or that they were more efficiently organized or that some new comer was foolishly selling the goods very cheap in the hope of getting a quick footing in the market. Those making poor articles will not long remain in business. The foolish person trying the silly method of selling below the cost of production cannot expect all competitors to go out of business. Quoting normal prices alone will ensure his survival. The more efficiently organized will have many points to teach:—

- (a) Scrutinize the cost of production in each department to find out waste of time or materials.
- (b) See that the machines give utmost production.
- (c) Examine defects in design or execution.

Unexpectedly larger sales create visions of larger profits with expanded production. Level headed industrialists do not expand in a hurry. They take stock of the situation, calculate how much more money will be required to finance the expansion on account of larger buildings, more machinery, higher stocks of raw materials and components, increased wage bills and larger carry-over of finished products if sales start halting.

There is often a pressure from the sales department to change design and/or the get-up of the existing product and even to take up allied lines. Though due weight is given to such suggestions coming from the salesmen it is remembered that they are often carried away by their anxiety to push up sales and have scarcely ever paid much attention to the difficulties regarding finance,

additional machinery and the ultimate effect on costs, selling price and sales.

### **Preliminaries Before Actually Starting the Factory :**

Certain investigations, inquiries and calculations (as detailed in Chapter III) are made before it is decided to put up a factory at a certain place for manufacture of a specified article.

The purchasing of land, buying of machinery and putting up the buildings, proceed apace as soon as the capital is collected. But hitches sometimes occur. Some of these are :—

- (a) The authority that is going to supply electric power intimates that it will not be able to supply it six months more, or
- (b) The foundry on which the factory had relied for important castings expresses doubts about its capacity to meet the exacting requirements of the factory.

Such developments naturally upset the original calculations of output and cost and further pose the serious questions :—

- (1) Will it be possible to get adequate production at reasonable costs ?
- (2) What will be the additional capital required for overcoming the difficulties ? In the above two instances the cost of (a) purchasing and running the electric generating equipment and (b) of putting up the foundry.
- (3) Can the company at this stage afford to spend the money ?
- (4) Is the commencing of running the factory to be postponed ?
- (5) Which of the staff and labour are to be disbanded or dismissed ?

It will almost always be found that final decision will be in favour of postponing the starting of the factory until all difficulties are overcome.



Rarely will any factory get away with ignoring the difficulties. Greater losses, after running for some time, will be the inevitable fate of almost all.

### Technicians:

No factory handling a new type of business starts production until the required number of technicians have been recruited and have joined.

Every large factory must have a competent general manager efficient works manager, experienced chief engineer and a talented chief chemist (where necessary) besides the foremen.

Engineering companies manufacturing complicated machines cannot do without a Production Engineer.

With every head of a department there should be "under-study", who can carry on in the absence of his superior.

### Human Element:

For nearly hundred years following the industrial Revolution the machine dominated over human considerations, but with growing complexities of modern large-scale production where each factory has several departments, each responsible for timely turning out of one or more items which together make the production of the final product possible, and requiring the physical and mental exertions of a large number of men and women possessing various degrees of intelligence, the human element is receiving due recognition.

The large masses of men that modern factories are required to employ must work in unison and harmony to ensure smooth working of the factory, because working of most departments is interdependent.

Selecting the right type of men and assigning them work, suited to their capacities and temperaments is the first step to success.

It is the general manager's acumen that welds them into a team by creating confidence among them that all are having a fair deal, merit alone gets the reward and sympathetic consideration is given to all their difficulties.

### Planning of Production :

With the decision to undertake the production of an item the entrepreneur starts planning of production, considering, for instance, the following points, if it is Engineering Industry.

- (1) What materials will be required?
- (2) What component will be required?
- (3) What machines will be required?
- (4) What tools and gadgets will be required?
- (5) What drawings will be required?
- (6) What castings will be required?
- (7) What time will be required for producing each of the parts?
- (8) What time will be required for machining parts requiring precision work for fitting them with others?
- (9) How can co-ordination in production of the several items required, be achieved when some parts can be produced by scores or hundreds in a day while others take days to be ready?
- (10) What parts should be contracted to smaller factories or purchased from other factories?
- (11) What should be the period for delivery of a particular item after receipt of order?
- (12) Which men will do the various jobs?

Since most departments are interdependent in a modern factory, no department can be allowed to work without reference to the needs of the other departments. Production planning is necessary in factories of appreciable size but it is very essential for engineering industries, because items like ring frames or motor cars are made of many parts, some of which are produced by the hundreds in a day while others take days to make. Co-ordinating of production of each of the several items and keeping on hand in time enough quantities to facilitate the making of the final product by assembly, is production planning.

Every factory is ordinarily geared to the minimum total production required over the year. Production planners get busy and have scope for their genius when accelerated production is wanted to cope with larger sales or when special jobs are undertaken.



The detail problems of production planning vary with each industry. The engineering industry only provides the indication of the minute attention to details required in planning. The problem of planning of production is one that is constantly receiving attention of all industrial concerns because their sales are affected by changes in fashion, decline in popularity of a particular product, model or design. A cotton mill might have to change the counts of the yarns or the quality or variety of the cloth due to changes in fashion, tastes or demand or even on account of special excise duties levied on a particular variety or varieties.

### **Labour Recruitment:**

The quality and quantity of production depends on the sincerity with which the people employed in the factory do their work. It is difficult to select all men of the right type in the beginning. Care therefore, is taken to have most men on probation so that undesirables like drunkards, quarrelsome and meddlesome persons can be weeded out at the earliest.

### **Purchase of Raw Materials and Stores:**

Purchases on a large scale are started only after water, power, transport etc., are available as anticipated and the plant and machinery is found working smoothly in a trial run. Some factories, like large glass factories with huge glass melting furnaces, cannot be stopped once the furnaces are fired and started. They must be run for two or three years continuously until they are due to be overhauled and relined with fire bricks. In their case the factory must immediately have stocks of sand, felspar, soda ash and cullets (broken pieces of glass) etc., sufficient to last at least for two months running.

In most of the industries the largest amount is spent on the main material used e.g. cotton in cotton textile mill. The quantity required to be purchased depends on the speed with which the material is turned into finished product. While a cotton textile mill producing thousands of yards of cloth requires about one hundred bales of full pressed cotton, every day, a factory making precision machinery, which requires time and patience, needs only small quantities of special types of steel.

The buying of the materials, components or chemicals must be related in quantities to the genuine requirements of the factory. Experience will show that maintaining on hand (by replacing as used up) stocks to cover three to six months requirements of the various items will be enough in most cases.

It is not the stocks of the big items that require attention, insignificant small items like carbide tips (used for machining) and diamond cutters (used for cutting sheet glass) if not kept on hand in enough quantities, can hold up work.

In 1948 when soda ash was placed on Open General Licence i.e. anybody could import it, one factory, though it was outside their ordinary course of business, imported a large quantity. As many greedy people had committed the same folly, soda ash soon became a drug on the market and the factory unnecessarily lost a large sum. This was rank speculation. An enthusiastic but immature general manager of a company, using chemicals, ordered, at the commencement, large stocks of a chemical liable to deterioration. This it could not have used up in three years. This was foolishness.

The most important reason why purchases are done in restricted quantities, is that no factory is able to sell its entire output in the beginning of the year. It cannot know for certain, how the prices of the raw material and various other items will behave. If a factory bought large quantities in the beginning and prices went down later, its competitors will be able to purchase the material and other items cheaper and will be able to sell their product at a lower price. Every business has to take some risk and buy some stocks in anticipation of sales. The purchases should be reasonable in quantity and not savour of speculation or stupidity, like a small woollen mills buying such a huge quantity of wool tops in London, that even if a bank were to lend them upto 75 % of their value, the mill had no money to deposit the margin.

Purchasing and stocking materials etc., means paying for them and even if the banks lend upto 75 % of the value it might be inconvenient to find the balance of 25 % and the dead weight of interest charged adds to the costs.



In medium sized factories or where there are few items to be bought the purchases are attended to by the general manager. Larger organizations have a Purchase Officer with full or restricted powers.

It is not possible for one man to get an idea of the existing stocks on hand, expected consumption and probable requirements of each of the several departments. The "Indent system" by which each department conveys its next few month's requirements to the Purchase Officer, through the Works Manager or the General Manager, works very smoothly. The heads of the department, must be alert to put in their demands for additional supplies, as and when extra large orders are accepted.

Every department must have a separate "Order Book" and all orders placed must be entered in this book, and serially numbered. The copies of the orders must go to other departments interested in knowing whether the order has been placed. One copy must invariably go to the Accounts Department.

The order must specify the quality or indentifying marks of the material or item indented, the quantity required and the date by which it should be delivered.

If each department is given a distinguishing number or a set of letters to be prefixed to its order-number, and the Purchase Officer quotes it in his written order, to the suppliers with a request to mention it on the invoice or delivery memo, the store keeper or the gateman knows whom to deliver it to or whom to inform of its arrival.

All orders to the suppliers must be given in writing and under the signature of properly authorised person who must keep a proper record with copies to the Accountant, who alone will arrange to make payments.

Urgent orders are sometimes placed by telephone but they must also be confirmed, without delay, in writing in the usual way.

The people actually working directly on production are not asked to attend to purchases.

*Skill in purchasing:* The prices paid for the purchases have important bearing on the ultimate cost of production. The skillful and knowledgeable purchaser knows where, when and how to secure his requirements at the lowest prices. He is equipped with full information about alternative sources of supply.

### **When the Ordered Goods Come In :**

It must be the duty of one person to receive all goods coming into the factory. He should be responsible for checking them with the copy of the written orders placed, verify the quantity and quality, wherever possible, and to pass receipts himself or on the initials of the department that has ordered the goods. His register of goods received must show every item received and to whom it was delivered.

### **Stores and Storing :**

A factory purchases hundreds of different things like raw materials, components, oils, lubricants, coal, steel, screws, packing cases, etc. Some of these are bulky while some are small.

Proper storing is as important as keeping them in stock. Bulky articles go in separate godowns, while small ones are taken charge of by the department using them or by the Store Keeper whose duty it is to arrange and store them in an easily accessible manner.

The godown keeper and the store keeper are accountable for every item received by them.

All stores must be protected against damage and pilferage.

### **Issue of Materials :**

If the godown keeper or the store keeper is allowed to issue or deliver goods from his charge on oral requests there will be chaos and no record of what actually happened to the stores.

On the contrary, if materials are issued from the godown or stores against requisitions signed by proper persons belonging to the departments entitled to use the item, there will be regular



record showing which department used what articles and of how much value. Properly tabulated record is a great help in calculating the cost of production.

### **Accounting for Materials Consumed and Statistics of Production Attained:**

There is always an estimate of costs prepared before it is decided to produce an item. This estimate records the quantities of raw materials and components that will be required. It should therefore, be possible to get fair comparison from the statistics of materials and components drawn by the departments and the quantity of the item turned out. Rough idea of the material in process could be obtained to correct the differences noted in the test, after allowing for usual wastes and actual rejections.

When only one product is produced from only one principal raw material, as in the case of a sugar factory, the checking is easy.

Though the task might be more difficult when the ultimate product is the result of assembly of various components, the relation, obtaining between materials consumed and the production attained, must be frequently checked with the estimate.

### **Tally of Balance on Hand:**

Where care is not taken to guard or keep under proper custody all items received in the factory, the books where receipts and deliveries are properly recorded, might show quantities that should be on hand, but the balances actually on hand and available might not correspond with those shown by the books.

Pilferages apart, it is likely that they might have been put to uses in the factory, but in unexpected ways. Felspar received in a glass factory and lying in the open might be found used in making a road. Fire bricks lying in one corner were perhaps utilised along with ordinary bricks while erecting a building. The disappearances are likely to be discovered when the materials are badly needed.

Taking physical count of the stocks on hand and comparing the quantities with the balances in the books, at intervals, ensures that stocks on hand tally with the balances shown in the books.

**Production :**

The raw material in every industry passes through many processes before the finished product is ready. Unless there is inspection after every process, the article might be found useless at a late stage. The fault may lie with man or machine. In the engineering industry if the base of a component is of 4" diameter and through the carelessness of a mechanic or machine setter it is machined for  $3\frac{3}{4}$ " diameter, and there is no inspection immediately after the machining, the component will be worked upon by subsequent operators giving it the final shape. The mistake will be detected at the time of assembly when the component will not fit, and the whole quantity of the component wrongly machined in the beginning, will have to be scrapped. The money, time and labour will have been unnecessarily wasted.

Some mistakes can be rectified. If the casting had been machined  $4\frac{1}{4}$ " the inspector could have got the circumference machined again to 4" diameter.

Machines are also likely to go wrong and the production in sugar, cement and chemical factories requires inspection at succeeding stages.

*Assembly:* In the engineering industry most products are made by assembling together several components, as in cycles, sewing, machines, oil engines, motor cars etc. The dimensions of the components must be carefully worked out to fit into each other. For instance a piston made for a cylinder must fit properly into the cylinder, it can be too loose or so large that it would not go in. For fitting into each other, there must be a slight margin. This is known as "Tolerance" and these tolerances, worked out very fine, are achieved by precision machining.

Of course, every factory must have the required number of all the components for each product ready, to facilitate assembly of the several cycles, sewing machines or motor cars or oil engines, to be assembled every day.

*Testing:* When the assembling is completed, the product, oil engine, motor etc., as the case may be, is ready to be used. But no



factory will deliver it to the buyer until it has, after usual tests, made sure that it is working smoothly and satisfactorily.

### **Packing:**

Packing is often preceded by Packaging. A cotton mill which has sold 500 yards of a particular cloth does not send one long piece of that length. It divides the cloth into 25 packages of 20 yards each. The 25 packages are packed in one bale. The wholesaler buys in bales, the retailer in packages of 20 yards each, and the consumers takes pieces of suitable length out of the 20 yard packages.

Some of the goods are sold, to the consumers, in packages of smaller sizes, made by the manufacturers themselves, for example, tooth paste. The packaging, then must be attractive.

Packing covers all operations designated to protect the goods from damage or breakage during transit from the factory to the buyer in his town or place. A dealer buying one hundred radio sets does not get each one delivered separately to him. The manufacturer gets special thick cardboard boxes, each made to hold one radio and has specially constructed wooden boxes, to conveniently hold, eight or a dozen radios. This wooden box is strong enough to protect the eight or dozen radios against damage or breakage in transit.

Packing is as important as it is necessary. It offers scope for ingenuity. In many cases packing can be best begun with assembly using rollers for the movement to the store or to the despatch platform.

### **Despatch.**

In well-managed factories no product is despatched unless it has undergone appropriate tests or inspection.

Factories will be happy if goods could be sent out of the factory or despatched as soon as they are produced. Some factories do have these lucky periods occasionally for short periods. Most factories have often to carry large portions of their productions in their godowns for some time. The goods can go out of the factory only when they are sold and that too only when the buyer

is ready to take delivery according to his contract. Few dealers in woollen cloth will take delivery of woollen textiles between March and September. A farmer putting up an oil engine will want delivery after the end of the rainy season.

Of course, if the factory maintain depots in many markets, the goods can go out of the factory and await disposal at the depots.

The buyer will be bound to take delivery of the specific goods ordered, if tendered in agreed quantities, at the time and at the place mentioned by him and on terms already settled, against payment of an amount correctly worked out.

If against an order for 5 oil engines to be delivered in Poona in October the buyer gets in July a railway receipt for 2 oil engines booked to Patna, he can well be indignant and refuse to pay. Any variation required in an already concluded contract, must be with the consent of the buyer.

All despatches must go out on a Despatch Note, a copy of which must go to the Accounts Department to prepare a Bill on the customer or to debit his account on proof of delivery, if payment has been received in advance. Unless all despatches are followed till payment is received, there is the risk of the goods reaching the destination, lying unclaimed and therefore being disposed of as unclaimed.

It is the salesman's responsibility to see that the goods despatched to the customer, secured by him, are either paid for by the customer or are cleared and stored until final instructions regarding disposal are received.

Goods are despatched by air, rail, steamer, motor trucks or even sailing ships, when there is no other convenient means of transport.

It is cheaper to send goods by rail but buyers stipulate transport by motor trucks, paying slightly higher transport costs.

Motor lorries or trucks take the goods from the factory direct to the godown of the buyer quicker and without breakage or damage, which is far greater in railway, particularly when transshipment from a metre gauge railway to a broad gauge railway or vice-versa is involved.

Large or valuable consignments should be insured for transit.



**Sales :**

A factory must sell what it can produce and produce what it can sell.

The “ Production ” and “ Sales ” are two important wings of a factory.

The sales side knows what the factory is producing and can produce, and its duty is to sell the entire production. Salesmanship is essential to consumer goods manufacturing industries like cloth, soap, toilet, powders etc., but it is also useful for engineering and other industries. Fashions change. Consumers prefer goods packed in better containers or deteriorating economic conditions create preference for cheaper articles. Competing manufacturers make improvements in cycles, put on the market radios with attractive cabinets or machinery makers improve the performance by adding a few gadgets to save labour or trouble and promise earlier deliveries.

**Selling Agents :**

If a tincan factory starts work on a medium scale and secures orders from a very large factory manufacturing toilet powders to buy its entire production, it will have no problem of selling its production. The delightfully simple solution of the problem, however carries one serious draw back. If the single bulk purchaser suddenly stops buying, for any reason, the medium sized factory might find itself in difficulties.

A factory can go on running and producing if it can sell a large part of its production. Some new factories therefore, arrange with leading dealers, selling their type of products, to take selling agencies, agreeing to lift a certain portion of the factories' production.

This arrangement generally works fairly well when the production is small in the beginning. The dealer is handling many lines and is not interested in pushing the sales of the products of a particular company except when the commission is large and sales are not difficult. The selling agents get lukewarm when there is sales resistance or keen competition, which is the time when the manufacturer needs their assistance most.

Giving of selling agency to two or three people does not therefore really offer a lasting solution of the sales-problem.

Every manufacturing concern must develop its own selling organisation to sell its products to numerous dealers in all parts of the country and abroad, if possible.

The happy interlude when it had one buyer to take up the entire production or a few well-known dealers to take a substantial part of the production before the factory got into stride, should be used to plan out its sales-programme to be vigorously put into effect when the situation demanded turning over a new leaf.

### Market Research:

The manufacturer must have a nose for finding out markets, (which terms includes all types of buyers) where he can sell his products. His representatives must always be on the alert to find out if any products of a competing manufacture have come on the markets and at what price they are selling. The representative's reports must mention the comments of the buyers or users on the respective merits of the products of his own company and those of the competitor's. Every point in a competent sales-representatives report, whether it relates to price differential, design, packing performance, delays in delivery, alteration in design etc., must be given full consideration.

*Quality:* The best way to develop sales is to maintain high standard of quality and performance.

*After-Sale Service:* Factories manufacturing machinery like, spinning frames, carding engines, oil engines, motor cars, etc. must have efficient after-sales service, as minor defects are likely to come to notice when the buyer starts using the machines.

*Replacements:* Major defects, pointed out by honest buyers immediately after trial, should be honestly and politely acknowledged and defective items should be replaced without extra charge.

*Advertisement:* Wide and attractive advertising, through right channels, has marvellous power of bringing in business.

*Punctuality in giving deliveries:* It is fatal to go on accepting orders, when the manufacturer knows full well that with his limited production capacity he will not be able to produce the goods and deliver it on the dates promised.



A manufacturer must establish reputation for punctual deliveries. In business, the failure of one person to keep his promise upsets the programmes of many. If a foundry fails to give castings on the date promised, the machining capacity of the purchaser remains idle, the failure to get the important part machined in time delays assembly of a complicated piece of machinery urgently required to be delivered.

### Graphs :

A tinsmith, buys tin-sheets, makes cans, tinpots, lanterns and sells them. He attends to purchase, manufacture, sale and is able to know the position of his business from time to time. But a general manager running a big factory has many departments under him, and sometimes his factory is producing, two or more articles, and his task is more difficult because the production of one of the articles at the cost at which he is producing, may be very paying, while that of the other articles might be being done at a loss. To find out the results of separate departments he must have more detailed information about the working of each department. The net result of the working of a factory can be more definitely ascertained by considering its working over a period of say 6 or 12 months, but indications can be more frequently obtained if the statistics relating to the various department are up-to-date, and concurrently available. Each factory knows whether it is run at profit or at a loss only when it has got the figures of its expenditure and income, both covering the same period. The main items of expenditure in most cases are costs of raw materials, stores and spares, wages and power or fuel used. The other items, of course, include administrative expenses, depreciation, insurance, rates, taxes etc. which are more or less fixed.

Against the expenditure incurred, the company holds the proceeds of the goods already sold, the stocks on hand of raw materials and finished products and the stores and spares on hand.

The statistics relating to various departments pictorially presented are known as graphs. In reading tabulated statistics one might not easily notice the exact degrees of ups and downs and might overlook precipitate rise or fall. The graphs bring these variations vividly to attention.

The graphs should cover the information on the following, day, week or month as might be convenient.

1. Material consumed.
2. Labour employed.
3. Labour paid.
4. Over heads.
5. Electricity consumed.
6. Coal consumed.
7. Production attained.
8. Sales.
9. Finished products on hand.
10. Total hours for which the factory worked.

The graphs might occasionally show that:

- (a) Though the labour employed was the same the production was lower.
- (b) The consumption of electricity had shot up, though work load or working hours had not increased.

If each department is not sending its own graphs with detail explanations for the variations they must be made to do so.

### Reclaiming of Waste:

Nothing should be thrown or discarded, or disposed of at nominal price because it appears worthless. In those industries, where the competition is very keen the throwing away of what is considered 'Waste' might with some investment turn the concern into profit-earning instead of losing. The zip fastener industry uses less than 1/3 of the brass strips. Molasses of sugar mills, if turned into spirit and power alcohol, might bring in profits. The paper mills can reclaim large part of the caustic soda used, if they have a soda-recovery plant. In the engineering industry some parts likely to be rejected outright can be set right under expert guidance.

### Research:

Research does not always connote a big laboratory manned by leading scientists. The laboratories grow from small beginnings and attain huge sizes and cover a variety of subjects as the factories expand. Imperial Chemical Industries have over these



years established 18 research stations involving a capital investment of £ 8,500,000.

Every factory must have a small laboratory where it can at least carry out minor tests on the raw material, components and finished products.

Research must attend to two aspects of production. (a) improving the quality (b) reducing the cost of production. Complaints from the buyers pointing out defects provide the start for the research to remove the defects. The degree of ingenuity possessed by the technical staff makes a beginning in reducing costs.

### Story of the years' working:

In a simpler form the results of the working of a factory for twelve months would appear as follows :

	Rs.
I. Materials consumed:	10,20,500
II. Wages.	4,97,000
III. Factory expenses.	
1. Salaries and Wages	74,000
2. Consumable Tools	21,500
3. Electricity and Fuel	32,000
4. Maintenance and Repairs	37,200
5. Freight and Cartage	18,000
6. Stationery	6,500
7. Telephone and postage	9,000
8. Insurance	14,100
IV. Overheads.	
1. Staff Salaries	8,840
2. Rent, Rates, taxes	3,340
3. Bank charges	80
4. Audit	130
5. General Expenses	4,280
6. Insurance	330
7. Depreciation	4,500
Total cost of Production	Rs. 17,51,300
Expected Sale Proceeds	Rs. <u>24,40,200</u>

Some of the production has of course been sold in the course of the year, some is to be delivered according to the contracts of sales already made and the balance of production on hand has to be valued at cost or market price whichever is lower. The production which has actually cost Rs. 17,51,300/- is expected to realise on the whole Rs. 24,40,200. This will leave a surplus of Rs. 6,88,900/-, over the cost of production.

This surplus is really required to meet:

- (a) Expenses of selling, advertising etc.
- (b) The interest on the monies borrowed, if any.
- (c) Taxes on the profit, and the dividend to the share-holders who have invested capital in the company.
- (d) For building up a reserve fund and meeting miscellaneous expenses.

### Overheads:

The expenditure which a factory has to incur to get the total production in the year generally falls under two categories:

- (i) that incurred directly in the manufacture of the product ; and
- (ii) that entailed for general management, upkeep and running of the factory.

If a factory is manufacturing a single product its overhead expenses i.e. its expenses not directly connected with the manufacture of the item will be constant and can easily be allocated towards the total production of the year. But when a factory is handling more than one line and is often undertaking special jobs, it cannot do without having a system by which it would be able to allocate and recover at the end of the year, all overhead charges incurred by the factory on all the work done during the year. The distinction between overhead expenses and overhead charges should be clearly understood. Overhead expenses of the factory cover all items of expenditure except the direct cost of material, labour and expenditure on capital items like dies, etc., used for the particular jobs. Overhead charges is a contribution, which every separate job undertaken must make towards the total overhead expenses of the factory. The overhead charges on the several jobs done in the factory must naturally cover the total



overhead expenses incurred by the factory during the year. The expenditure incurred directly in the manufacture of the item is generally the cost of the raw material and the direct labour spent on processing that raw material for turning it into a finished product. The expenditure on these items will go up and down as the production is increased or decreased. If the production is more, more raw material will be consumed and more labour will be employed. If the production goes down less raw material will be consumed and if possible less money will be spent on the smaller labour force employed. If production goes down, naturally less raw material is consumed, but it is not always possible to reduce the number of workers correspondingly, until it is definite that the factory is not going to get enough work for some time and must reduce the number of workers.

The overhead charges of a factory generally include the expenses under the following heads :

- Works Salaries.
- Indirect Labour.
- Consumable Materials (oils, cotton waste).
- Consumable Tools.
- Maintenance and Repairs.
- Packing.
- Freight and Cartage.
- Stationery.
- Telephone and Postages.
- Insurance, Employees State Insurance etc.
- Water, Power, Gas and Fuel.
- Staff salaries.
- Rent, Rates and Taxes.
- Bank Charges.
- Drawing Office.
- Administration.
- Audit.
- General Expenses (Canteen, Sports, Legal).
- Insurance (Buildings and Stock).
- Depreciation.
- Selling, Advertising and Distributing.

With proper cost accounting it may be possible to allocate certain part of these to actual manufacturing cost. In the matter of labour charges on job items, much time is wasted in stopping the machine which was previously doing a particular job and taking out the previous attachments and setting the machines with new attachments for the new job. This cost must naturally fall on the new item to be manufactured. The new job also may require certain dies and gauges to be made which will be useless if repeat orders are not received for the job. Therefore, the cost of making those dies and gauges for that particular item must be included in the overhead expenses for that job or item. So also will have to be included consumable tools like a carbide tips and consumable materials like oil, waste and other materials that will have to be used on that job.

*Allocation :* The system of allocating overhead charges to various departments or to various jobs undertaken differ with different factories. Most factories relate it to the labour cost involved and fix it at so many times the labour cost. Others prefer to base it on the actual labour hours spent on the manufacture, including of course the proportionate labour hours that have to be added to the job on account of the over-all lost labour hours which include, lost time, holiday reserve, over-time wages paid etc. The estimating of overheads are important because the cost of raw material and labour does not give the actual cost of production to the factory and if the factory is particularly taking on many jobs or running many departments, the factory must know whether each job and every department is contributing adequately its share to the total overhead expenses of the factory.

*Estimating and Costing :* Estimating means calculating the cost of a product before it is made ; Costing is finding out the cost of the product after it has been made. Both are, therefore, very important in a factory. The estimator's job requires a lot of skill because he has to arrive at his decision from the data and information supplied by the various departments, which will be handling the ultimate product through various processes and will also have to take into account every single item of expense incurred in the running of the factory whether it is raw material, labour,



overheads etc. If his calculations are correct and the factory has accepted orders on the basis of his calculation and executed them, the factory will have made a profit. His mistakes cause losses. Every factory, therefore, must at the beginning of the year supply the estimator with the basis on which the estimator can rely. In many factories the following information is supplied to the estimating section at the beginning of each year.

1. Average material consumed percentage.
2. Direct labour cost for a year.
3. Ratio of overhead charge to direct labour charge or time value to be used for the overhead charge.

Of course if any revision of these figures supplied to the estimator becomes necessary on account of the state of business of the factory it must be immediately intimated to the estimator. Estimating the cost of a completely new article, never made in the factory before, is complex and difficult. Estimating the cost of an article which has been made in the factory for some time and for which records of the cost of raw materials, components, time taken etc. are available, is a simpler affair. The estimator's job in a bigger and well established factory, is easy, because there the orders of the customer asking for quotation passes through various departments like the drawing department, the planning department etc. Each department gives him the available information from the records and he has to write down, item by item, the cost of material the cost of labour involved in each operation through which the material passes until it becomes the final product. Finally he adds up all these to get the actual manufacturing cost, makes allowances for inefficiency or delay in following the timing and the overheads and is ready with his answer. Very often this is more or less a mathematical answer, and generally applicable in case of small orders. But where competition is keen, the order expected is large and the connection is likely to prove very valuable, the estimator has to use his skill, judgement and experience and keep his quotation low and at the same time remunerative.

### **Laws affecting factories :**

Since the factories bring together a large number of men and some of them, on account of the nature of their operations,

make them work under-ground or in surroundings where the air is being vitiated, their lungs or skins are affected and there is risk to life or limb due to failure or breaking of machinery, it was necessary to pass special laws requiring the factories to take special precautions and to enable workers to get compensation for injuries suffered during their employment in the factories.

Later legislation granted pecuniary and other benefits to the workers, like Provident Fund, paid-leave, holidays and medical aid.

Various other old and new enactments make the factories take out licences, compell them to allow inspections and enjoin on them to submit several returns. The statutes that hit them harder are those which affect them financially, like the "Wealth Tax" and the Act empowering Village Authorities (Gram Panchayats) to levy octroi duties. When so many laws are passed every few months in the present conditions in India, no entrepreneur can escape making a careful study of the provisions of all the laws he will be subject to.

A list of the various Acts which a very efficiently run factory, situated on the Bombay—Poona Road, away from the big cities, keeps is given in Appendix 'A'.

It is reported that the industrial concerns have to keep, besides these Acts, a copy of a special Act relating to the particular industry if such an Act is in force.

### **Book keeping and Accounts:**

The real business of factory is to make sufficient profits to cover, dividend on capital, interest on funds borrowed, depreciation on machinery and the administration and sales expenses. A clever accountant is a real force and helps the general manager to review the day to day state of affairs and to take the necessary decisions regarding purchases, production, prices, sales, borrowings, recoveries, payments, repayments etc.



An accountant is not a book-keeper merely recording the receipts and payments. All receipt and payments pass through him. He is in position to detect whether (a) raw materials and components are being purchased at rates higher than usual or expected (b) bills for wages, water, fuel or electricity are shooting up without increase in production etc. In fact he must have his explanation ready for the abnormal variations disclosed by the graphs. If he failed to advice the management, in time about the factory's debt liabilities accruing due and financial arrangements that must be made to meet them, the factory's credit might be ruined. The accountant has at his finger tips the difference it will make, to the cost of production or the profit earning capacity or the financial capacity of the company if purchases were made at higher prices or money was borrowed for short periods at onerous rates or commitment were made without due regard to financial resources available with the company.

A first class accountant knows what books and registers he should compel the various departments to maintain, what returns, statements and graphs he should get, in what forms and at what intervals and what control he should have on the financial transactions.

The Directors and General Managers of factories must be acquainted with the fundamentals of preparing a balance-sheet and it would be at an advantage if they were conversant with provisions regarding depreciation allowances, rebates and labour laws.

### **Arrangements with banks :**

Since modern factories have to keep large stocks of raw materials and have to hold the finished product till it is delivered to the buyers, they have to invest large sums of money to acquire the material and to hold the stocks.

The amount of money that remains locked up in these is often larger than the paid up capital of the company, much of which has been utilized in acquiring land, buildings, plant and machinery.

Rarely has any factory enough resources saved to handle the financing without the help of a commercial bank. The commercial bank only advances against easily saleable raw materials and finished products. It may, if the standing of the management is very high, agree to lend against raw materials and finished products which may not be readily saleable but might insist on a higher margin in its favour. The bank may advance against hypothecation of both type of goods or against pledge of both type of goods depending on the standing of the company. In case of hypothecation the possession remains with the borrower, in case of pledge the goods remain in the custody of the lenders. When a bank advances against hypothecation it requires statements from the borrower showing the correct amount of the stocks of the various articles in possession of the factory, on the particular date to which the statement relates. When the goods are under the control of the lender, he does not release the goods without receiving the amount already lent against the goods or additional goods equal in value to the goods to be delivered.

The arrangement with the bank covers conditions, similar to those applicable to a cotton mill which are given below:

1. The total advance will not exceed Rs. 50 lacs.
2. The security will be all stocks of cotton, yarn and cloth.
3. The amount of advance will be 75% of the market value of the cotton, yarn and piece goods.
4. Where the advance is against hypothecation of the stocks of cotton, yarn and cloth, the borrower will always see that there is Rs. 100/- worth of good hypothecated for every Rs. 75 borrowed by him.
5. All stocks pledged or hypothecated are insured for their full market value with an approved insurance company.
6. Correct statements of goods hypothecated will be furnished to the bank under the signature of a duly authorised person every week. In case of goods pledged, similar statements will be furnished every three months.



7. The bank will have right to inspect the stocks any time at its discretion.

8. Interest on the amounts actually borrowed will be charged at the rate of 2% over the Reserve Bank of India rate with a minimum of  $5\frac{1}{2}$  % per annum and will be recovered every quarter.

Other conditions and more details of the above conditions are found in the printed documents executed by the borrowers in favour of the bank.

The banks trust the borrowers with large amounts and expect utmost accuracy and honesty of them.

Attempts to cheat the banks by showing larger stocks to get more money, cannot succeed. No fraud can remain hidden long.

The statement to the bank must be very accurately prepared and carefully checked to avoid creating suspicion.

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## **PART II**





# **INDUSTRIAL FINANCE**

## **CHAPTER I**

### **Difference Between Commercial Banking and Industrial Finance :**

The commercial banks can help industries by financing the industries and by handling industrial finance. They finance industries by granting them advances under overdraft or cash credit arrangements against hypothecation or pledge of their raw materials and finished products if both are easily saleable. Industrial finance, on the other hand, means giving medium term or long term loans to industrial concerns against the mortgage of their fixed assets like land, building, plant and machinery on the expectation that they will benefit by the financial assistance, will earn adequate profits, and will repay the loan by instalments in a few years. Some financial institutions extend industrial finance by taking preference or ordinary shares in the company owning the industrial concern and some even require a share in the profits. Ordinary shares are often taken to lessen the burden of interest charge on a smaller company, but some times they are taken to compensate the financing institutions which took the risk of the failure of the scheme financed and to share in the prosperity of the concern.

Industrial finance is more intricate and more fascinating. Instead of dealing with inert goods and securities it deals with living organisations.

The fundamental test that every borrower must have credit, capacity and character will, of course, govern loans and advances for industrial finance.

The commercial banks have been financing industries because there they get easily realisable securities. They have been chary of undertaking industrial finance because it means locking up their funds for years against securities which might fetch only a fraction of the amount advanced, if the industrial concern failed.



It is not that, all these years, commercial banks all over the world, have absolutely refused to lend against mortgage of the fixed assets of industrial units. Only, their general attitude and the degree of their willingness to lend were governed by several different factors in different countries, mainly:—

*The Safty of the Advance:* The safety of the advance was the primary consideration in case of industrial concerns in the under—developed countries, where the governments were not prepared to grant Protection to the industries and the industrial concerns were often unable to withstand competition from foreign imports. The commercial banks therefore, did not like to take chances with advances to industries. The Tata Industrial Bank tried this experiment in India, and it is said that some of the industries which were established in proper places under proper guidance failed for lack of Protection.

*Stability of the Deposits:* As commercial banks take deposits for short periods they want to lend against securities which can be realised without loss, at short notice. They therefore, could not venture to enter the field of industrial finance until they knew, that their deposits were very stable and that they could utilize a part of their deposits for long-term finance. They were also afraid that, if they once entered the field, they might be accused of discrimination between borrowers, in case, they rejected a large number of applications out of those that poured in, and that they might even be tempted to lock up in such advances a much larger portion of their deposits than they could spare.

*Demand for such Advances:* In Britain, commercial banks occasionally helped individual industrial concerns by taking mortgages or debentures, but they studiously avoided such advances as a general rule. This was because there was in Britain a class of wealthy private individuals, who had the will to invest and ability to choose the investments, and prospectuses or offers for shares by good concerns never lacked adequate response. There was in fact no appreciable demand on commercial banks, by big companies for industrial finance. With the disappearance of this class as a result of heavy taxation, it is not so

easy now to collect capital. The British banks recently had to discuss whether in the altered circumstances, they should change their old policy and take wider and more sustained interest in directly making advances to industrial concerns.

Even as early as the twenties there were complaints in Britain that small companies requiring between £ 500 and £ 200,000 and companies wanting finance for short period, say less than 5 years, were finding it difficult to secure the needed assistance. The Government had, therefore, to appoint the Macmillan Committee, which in their report published in 1931. had among other conclusions stated that there was a possible need for new institutions to provide,

1. Intermediate credit (for 1 to 5 years) for enterprises of all sizes.
2. Long term credit for small and medium sized business which were unsuited for new issue financing.

The reasons why such credits were not forth-coming were in the case of the first, that such credit would be normally of too long a period for banks and too short a period for new issue financing through the Stock Exchange and (b) in the case of the second, that the borrowers were too small to attempt raising share capital from the public.

In India the position before the Second World War was that, in the absence of Protection, only those industries which had real and natural advantages, could hold their own in the face of foreign competition. These industries were run by managing agents, who generally were firms with large resources, and enjoyed unimpeachable standing for integrity and high reputation for efficiency. The few industrial concerns that required industrial finance, before the war for expansion of their plants, were easily able to get the necessary funds by placing debentures privately or in the open market, at rates related to the standing of the borrowers and the periods for which the debentures were issued.



But conditions have changed, both in Britain and in India. In Britain the monied class, who used to have substantial incomes from their investments, have very little left to invest after the heavy taxation and various other levies like Estate Duty, which take a very big slice out of the family's property on succession. With the disappearance of the ruling princes, and the feudal aristocracy and the impoverishment of the rich people of the Punjab by Partition, the perennial fountains, which fed the stock exchanges and money markets in India, have dried up. On the other hand, the country is trying to force the pace of industrial development and more and more factories are coming into existence. Hence, the special interest all over the country in industrial finance.

*Proportion of Aggregate Demand to the Banks' Deposits :* Even when the circumstances are propitious for commercial banks to enter the field of industrial finance, they would much rather avoid taking the risk single-handed, if the demand for industrial finance was likely to exceed the ratio of such advances to their deposits.

In such circumstances, the Government and inter-national financial institutions like the World Bank have to step in to handle the larger or more complicated type of advances, like the one to the Tata Iron and Steel Company Ltd.

*Banks' Knowledge of Industries Requiring Assistance :* The German and the Swiss banks specialised in promoting and financing particular types of industries. American banks which have been doing industrial finance for a long time, are familiar with the running of various industries, and are willing to extend industrial finance. If the risks are large, four or five banks combine and share the risk.

*Interest Felt by Banks in Developing Industries in the Areas Covered by their Operations :* If the commercial banks have enough liquid advances, they will not be tempted to go in for advances against fixed assets like land, building and machinery. This was the position in India before the Second World War. The commercial banks in India were mostly run by foreigners.

They had enough liquid advances covering import and export trade of India and substantial portfolio of advances to flourishing industrial concerns run by foreigners. Most of the banks being British, they were influenced by the policy of the banks in Britain, who were not encouraging, or were not required to encourage, advances to industrial concerns against their block assets.

*Attitude of the Central Bank of the Country to the Question of Commercial Banks Entering this Field:* The Central Bank of a country has a big say in the matter of the policy regarding advances which the commercial banks in their jurisdiction should follow. India's Central Bank, the Reserve Bank of India, was until recently opposed to commercial banks taking interest in industrial finance though the Central Banking Inquiry Committee had, as far back as 1931, advised leading banks to undertake that business.

### **No Standard Yard Stick for Judging Applications :**

Every application for industrial finance has to be studied from various angles and might present certain peculiar, interesting and important characteristics. The final decision will have to be struck on individual important points like the prospects of the Company, capabilities of the managements or the national importance or the pioneer nature of the industry.

Not only will the safe quantum of the assistance have to be fixed but also in some cases, the form in which it will have to be rendered, tailored to the needs of the industry. For instance, in case of a very deserving industry which cannot stand the strain of heavy interest charge on a debt, a large part of the assistance will have to be given by taking ordinary shares in the company.

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## CHAPTER II

### RECENT ATTENTION TO INDUSTRIAL FINANCE

#### **Resources not enough for Post War Reconstruction and Replacement of Obsolete Machinery:**

The Second World War lasted for nearly six years, involving almost all the industrially advanced countries. The factories in the countries engaged in the War and in the territories ruled by them had been made to switch on to war production. No factory even in these countries was able to get replacement of its own machinery, which was overworked, for supplying the needs of their own people, when imports from other countries were not possible. Many industrial units and industrial centres in many countries were damaged or destroyed by bombing, scorched-earth policy or dismantling by the victors.

The advanced countries involved in the war had therefore to replace old machinery on a large scale and had to re-start industries which were bombed out or destroyed during the hostilities.

Another effect of the war was that under-developed countries had awakened to their dependence on imports for the ordinary necessities of life and were trying to set up new industries in their own countries.

The crushing burden of debt, caused by the war, had raised taxation to a very high level in most of the countries and it was becoming difficult for industrial organisations to get capital directly from the public, which could no longer afford to buy shares or debentures on the pre-war scale.

The Second World War – fought mostly with mechanical weapons improved with the aid of science – helped to make progress in improving the processes and machines formerly used in industry. Many of the factories, which had switched over to

wartime production on account of compulsion from Government or on account of the large wartime contracts that they had secured, had to go back to producing the articles they were manufacturing before the war or to better articles, which they could manufacture, after the war, with the help of the machines or processes invented during the war. They had to replace their old machinery with up-to-date machines.

All these replacements could not be made from the factories' own resources. They now required large additional capital and had to turn their attention to the problem of procuring finance. The amount of capital that was required for financing the individual industries either to be reconstructed in advanced countries or to be started from scratch in underdeveloped countries, or in countries where they did not exist on a large scale, was of such magnitude in some cases that neither could the companies raise it themselves nor could they get it from the usual channels. In many cases the banks did help in some countries but sometimes, either on account of the importance of the industry or the urgency with which it had to be established, and when the risk was such that the banks could not take it, the Governments had to step in and either start new organisations or departments to extend the required finance or to see that special institutions were established with Government's encouragement.

The type and degree of assistance, which the industries require at any particular period in the history of a country depend on the nature of the reasons that caused the requirements. When Japan was trying to emerge as an industrial nation fifty years ago its problems were different from those the United States had to face when recovering from the havoc caused by the depression of the early thirties. Germany's problems after the war were unprecedented when it had to rebuild and start new industries after the complete devastation by bombing. India and Australia, which were trying to build up new industries on a large scale had other problems besides the recent common problem of lack of adequate capital.



The manner in which the assistance can be given depends on the general economic advancement of the people, the existing banking systems, the capital market and upon the availability of funds from the public and the Government.

The counter-part funds of the American aid, in various forms to different countries, has in recent years placed large funds in the hands of the respective Governments which are being used for development of industries and for raising the standard of living of the people.

However instructive and interesting the history of the different measures taken in different countries under different circumstances, it is not possible to deal with them in a book of this type. For the real appreciation of the causes which led to the devising of the measures to assist industries, the manner in which the assistance was extended and success which attended these schemes, separate books will have to be written.

A book of this type, which is trying to explain the type of difficulties which industries have to face and the solutions that have to be found to overcome the difficulties, can only describe in barest outline the functions of the existing institutions working, in some selected countries to render every assistance to the industries in their territories.

### **Japan :**

**The Industrial Bank of Japan :** Japan has a group of important governmental and semi-governmental institutions specialising in industrial finance. Chief among them is the Industrial Bank of Japan which was formed by a special Act in 1900. Though its shares were held by the public, the Government maintained strict control over its policy. This is a hybrid institution. It does ordinary banking operations as well as handles medium and long-term financing on a large scale. Government now owns half of the capital. In 1951 about 3/4ths of the bank's loans were spread over six industries, machinery, textile, metal, chemical, mining and shipping.

**The Central Bank for Commerce and Industrial Co-operatives :** The capital of this institution is provided by the Government and by the various associations and co-operatives and their federations. It works under government control and is authorised to :

- (a) Issue debentures.
- (b) Accept deposits from co-operative agencies and public associations of non-commercial character.
- (c) Grant loans repayable within 20 years.
- (d) Discount bills and commercial paper of co-operative organisation and associations of small industry.
- (e) Act as banker to co-operative organisations and associations of small industry in rural area.

This organisation is established mainly for the benefit of small industries in rural areas.

**The Export Import Bank:** The Export Import Bank was originally established with the purpose of aiding Japan's export trade. But later its functions were enlarged. The bank is expressly prohibited from competing with other financing institutions and is to make amounts available in those cases where ordinary banks are unwilling to lend adequate amounts on reasonable terms. It is normally expected to make loans jointly with commercial banks but where it is not possible it is allowed to make loans independently. It is authorised :

- (a) To make loans to Japanese foreign traders for investment in foreign corporations or to Japanese manufacturers for the purchase of equipment required for their own enterprises in foreign countries, provided such loans would help the promotion of Japanese exports or help Japanese industries to get more advantageous source of imports.
- (b) To make loans to Japanese exporters or manufacturers of machinery and equipment including ships and rolling stocks and if necessary of other goods for exports.



- (c) To advance funds for the export of machinery and equipment before export contracts are concluded and also to cover guarantee in connection with contracts involving the export of machinery and equipment, abroad.
- (d) To make loans to foreign Governments, Banks, or firms, to facilitate the purchase of Japanese exports.
- (e) To make loans to Japanese importers or manufacturers to finance specified imports that are considered essential to the economy.
- (f) To discount bills for banks in connection with all the above type of loans, and
- (g) To guarantee liabilities associated with any of the above transactions.

**The Japan Development Bank:** This institution was established to promote Japan's economic reconstruction and industrial development and it can make credit available to important enterprises, when other financial institutions and security dealers consider the financing too risky or when conditions in the money market are such that recourse to capital market is undesirable. The bank is expected to concentrate more on:

- (a) Making loans for renovation, modernisation and expansion.
- (b) Investing in debentures issued by companies requiring funds for expansion and to subscribe to debentures floated by industrial concerns which desire to repay loans taken from commercial banks for capital expenditure.

### **United Kingdom:**

The United Kingdom on account of her outstanding position as a great industrial nation particularly depending on its export trade, had to pay special attention to Post-War reconstruction and development of her industries. It is noteworthy that although the Government displayed considerable interest in the formation of the several institutions for industrial finance all the institutions are ordinary limited companies with no official representation on the boards and having no recourse to public funds. The principal institutions are:—

**Finance Corporation for Industry Limited:** This institution was formed to assist in the provision of capital for re-equipmen and development of major industries with a view to promoting efficiency and thereby assisting in the maintenance and increase of employment and was intended to help those requiring £ 200,000 and upwards. The institution has an authorised and issued capital of £ 25 million and may borrow upto four times this amount. The share capital is held by Insurance Companies (40%), Trust companies (30%) and by the Bank of England (30%). It has no funds of its own besides the paid up capital, and depends on the British Banks. Though only a small percentage of the issued capital is paid up, the banks are willing to lend large sums on account of standing of the institution and the large uncalled capital.

**Industrial and Commercial Finance Corporation Limited:** The Industrial and Commercial Finance Corporation is a smaller institution and caters to the needs of the smaller borrowers requiring between £ 5,000 and £ 200,000. It provides credit and finance not only by loans but also by subscription to share capital, particularly in cases where the existing facilities provided by banking institutions and the Stock Exchange are not readily or easily available.

The authorised and issued capital of the Corporation is £ 15 million and is paid up as required. It can borrow further upto £ 30 million. The Bank of England has participated in the share capital but the amount is only nominal. The principal shareholders are the London Clearing Banks and Scottish Banks in proportion to their size. The funds for lending are provided by the shareholder banks in the same ratio as their share holdings. All its borrowers are small and medium size concerns and their number is large. It has, therefore, established branches in Birmingham, Leeds, Leicester, Manchester and Edinburgh to be able to serve the customers efficiently and promptly.

**Ship Mortgage Finance Corporation Limited:** Ship building being one of the important industries in the United Kingdom and its problems being different from those of ordinary industrial



concerns, this special institution was set up in 1951 with the object of assisting in financing ship building in the United Kingdom. The capital was subscribed by the ship building industries, Insurance companies and other financial institutions. Though the main object was to assist in financing new ship building in the United Kingdom, applications from owners of existing ships built in the United Kingdom were also considered.

**Air Finance Limited:** United Kingdom which was leading in ship building has also maintained its lead in building aircraft. The huge modern aircrafts often cost as much and more than ships and take longer in construction. The British aircraft companies, which were getting orders from foreign countries for aircrafts, required large finance for long periods during the construction of aircrafts and individual Banks were not in a position to take such big risks. As in the case of ship building a special institution was established by merchant banks and the Finance Corporation for Industry Ltd., in 1953 for the purpose of financing Aircraft exports with initial resources amounting to £ 11 million.

**Estate Duties Investment Trust Limited:** Certain Acts are passed in pursuance of certain ideologies but their immediate effects are often devastating. The levy of Estate Duty in the United Kingdom led to the ruin of many small family businesses, because the proprietors (heirs) had to sell their controlling interest in the companies to pay the Estate Duties on the death of one of the two Directors of a private limited company. This institution had, therefore, to be set up to assist small family businesses to find finance to meet Estate Duties.

The capital is £ 1 million subscribed by insurance and investment trust companies and by the I. C. F. C., which manages the undertaking.

Though the Government of United Kingdom has not actively participated in the working of the finance institutions for helping the industries, they could not ignore the fact that there were certain risks which prudent private financing institutions would not undertake. Government had, therefore, to establish National

**Film Finance Corporation**, a statutory body, to make loans to film producers and distributors in order to help finance the production of films. To support the export trade they had to create the **Export Credit Guarantee Department** to provide guarantees in connection with the export of goods, mainly produced in the United Kingdom, in the form of insurance against risk of loss through insolvency of the foreign buyer and adverse development outside the control of the exporter concern.

### **India :**

**Industrial Finance Corporation of India:** The first institution to be started in the country for reconstruction and development of industries was the Industrial Finance Corporation of India, established by special Act of Parliament in 1948. Its authorized capital is Rs. 10 crores divided into 20,000 shares of Rs. 5,000 each. Only 10,000 shares have been issued and are fully paid up. The Central Government, the Reserve Bank of India, scheduled banks, insurance companies, investment trusts and other like financial institutions and co-operative banks were permitted to subscribe to these shares. The remaining 10,000 shares may be issued with the sanction of the Central Government, from time to time, as and when the Corporation may deem fit.

For its lending operations the Corporation can augment its resources by issuing and selling bonds and debentures, which will be guaranteed by the Central Government. There is, however, a limit placed on the borrowing by the Corporation. The relative clause in the Act (Section 21, Clause 1) runs as follows :

“The total amount of the bonds and debentures issued and outstanding and of the contingent liabilities of the Corporation in the form of guarantees given by it or under-writing agreements entered into by it shall not at any time exceed ten times the amount of the paid up share capital and the reserve fund of the Corporation”.

The kinds of business the Corporation is authorized to handle is best summed up in Section 23 of the Act, which is reproduced below :



23(I) The Corporation shall, subject to the provisions of this Act, be authorised to carry on and transact the following kinds of business, namely :—

- (a) guaranteeing, on such terms and conditions as may be agreed upon, loans raised by industrial concerns which—
  - (i) are repayable within a period not exceeding twenty-five years, and
  - (ii) are floated in the public market ;
- (aa) guaranteeing on such terms and conditions as may be agreed upon, deferred payments due from any industrial concern in connection with its import of capital goods from outside India :

Provided that no such guarantee shall be given without prior approval of the Central Government ;

- (b) underwriting the issue of stock, shares, bonds or debentures by industrial concerns ;
- (c) receiving in consideration of the services mentioned in clauses (a) and (b) such commission as may be agreed upon ;
- (d) retaining as part of its assets any stock, shares, bonds or debentures which it may have to take up in fulfilment of its underwriting liabilities, so however that it disposes of the stock, shares, bonds or debentures so acquired as early as practicable (but in no case, the stocks, shares, bonds or debentures so acquired shall be retained beyond a period of seven years from the date of such acquisition, except with the permission of the Central Government).
- (e) granting loans or advances to, or subscribing to debentures of, industrial concerns, repayable within a period not exceeding twenty-five years from the date on which they are granted or subscribed to, as the case may be ;

- 1(ee) acting as agent for the Central Government or, with its approval, for the International Bank for Reconstruction and Development in the transaction of any business with an industrial concern in respect of loans or advances granted, or debentures subscribed, by either of them ;)
- and
- (f) generally, the doing of, all such matters and things as may be incidental to or consequential upon the exercise of its powers or the discharge of its duties under this Act.
- (2) No accommodation shall be given under 2 (clauses (a) and (e) of sub-section (I), unless it is secured by a sufficient pledge, mortgage, hypothecation or assignment of Government or other securities, stocks, shares or secured debentures, bullion, movable or immovable property or other tangible assets in the manner prescribed by regulations 3 (or unless it is guaranteed as to the repayment of principal and the payment of interest by the Central Government, State - Government, a scheduled bank or a State Co-operative Bank).

The types of industrial concerns eligible for assistance from the corporation are defined in Section 2 of the Act (See Appendix 'B').

At the end of June, 1958 it had sanctioned loans upto Rs. 6,2,90,00,000 out of which loans to the extent of Rs. 34,84,05,148 had been disbursed. Out of the sanctioned loans, loans for Rs. 10,42,92,000/- were either not made available or declined to be availed of by the borrowers. The difference between loans sanctioned and loans disbursed, is, due to the fact that the companies can start earnestly the construction of the factory and the ordering of the machinery only after the loan is sanctioned. It therefore takes one or two years for the companies to draw out the amount of the loan to meet the payments on the buildings and the machinery.

The Corporation is prohibited from subscribing directly to the shares or stock of companies and is expected to help in providing fixed capital and not compete with the commercial banks in the matters of loans for working capital. There is however no prohibition against lending for working capital.



The provisions of the Industrial Finance Corporation Act are reproduced in Appendix 'A' in order to illustrate as to how much into detail an Act has to go, if it governs the working of an industrial finance institution and also to give an idea of the very wide powers the Government of India has secured to control the working of the institution.

**The State Finance Corporations :** In a vast country like India it is not possible for one institution, like the Industrial Finance Corporation of India, to handle the applications of small individual borrowers or small companies from all parts of the country. Most of the States have, therefore, established Finance Corporations on the lines of the Industrial Finance Corporation of India to cater to the medium and long term needs of small factories owned particularly by private limited companies, firms and individuals who are not entitled to accommodation from the Industrial Finance Corporation of India. The paid up capital of each of these State Finance Corporations varies from Rs. 50 lacs to Rs. 1 crore.

**Industrial Credit and Investment Corporation of India Limited :** This Corporation came into being in January 1955 on account of the desire of the United Kingdom, the International Bank for Reconstruction and Development and the United States Government to help in promoting industrial development in the private sector in India. It was felt that the Industrial Finance Corporation of India could not work freely, on business lines, on account of the power the Central Government enjoyed, under the Industrial Finance Corporation of India Act of 1948, to control the policies of the institution and to issue directives. The authorised capital of Industrial Credit and Investment Corporation of India Ltd., is Rs. 25 crores of which Rs. 5 crores in ordinary shares of Rs 100/- each has been issued and paid up. Of this Rs. 5 crores, Rs. 2 crores was taken up by Indian banks, insurance companies and certain of the directors of the Industrial Credit and Investment Corporation of India Ltd., and their friends and associates. American subscribers took Rs. 50 lacs and subscribers

in the United Kingdom, including British Exchange Banks, United Kingdom and other Commonwealth insurance companies and others took up Re. 1 crore. The remaining Rs. 1½ crores in Ordinary Shares were offered for public subscription in India early in February 1955 and were over subscribed.

Its financial resources will consist off :

- (a) The paid up capital.
- (b) Any amount that Government of India may lend them from the proceeds accumulated from the U. S. A. aid in food grains and cotton etc., as per American Public law 480. Government has at present lent I. C. I. C. I. Rs. 7½ crores free of interest repayable in 15 equal instalments commencing after the expiry of 15 years.
- (c) Loans that the International Bank for Construction and Development (World Bank) will grant them.

Free from Government control and consequent redtapism and vexatious discussion in Parliament this institution has been able to transact business on commercial lines and has been very helpful in promoting establishment of big industrial enterprises. The I.C.I.C.I. generally transacts the following kinds of business but is prepared to handle most kinds of allied financial transactions.

- (a) Loans repayable over a period of years secured by a first mortgage of fixed assets. Such loans may be secured on debentures in cases where a public issue is practicable; in these cases financial assistance will normally take the form of underwriting.
- (b) Subscription to ordinary or preference capital normally in the form of underwriting of a public issue or of an offer to existing shareholders.
- (c) Guarantees of rupee payments, required, for instance, in the case of Deferred Payments for capital equipment.
- (d) Loans in Foreign Currency towards the cost of imported capital equipment.



**National Industrial Development Corporation :** This is an institution wholly owned by Government and works with funds placed at its disposal by the Government of India. This corporation had to be established particularly to make advances to Jute and Cotton mills because :

(1) The machinery of most of the Jute and Cotton mills was old and of antiquated design.

(2) The competition offered by mills in foreign countries which had put up new Jute mills with modern machinery and had modernised their Cotton mills taking advantage of the up-to-date machinery with the newest processes available.

(3) The amount of loans required by most of the Jute and Cotton mills for modernisation and renovation was so large that no finance institution, following business principles, could come forward to grant them the loans for the required amounts, particularly when the future of both the types of mills was uncertain. Jute products were facing world competition. The production of cotton mills was hampered by restrictions on introducing new types of machinery or looms and the rising costs and taxes. The Labour Legislation and novel schemes of taxation, were leaving very little out of the profits with the cotton mills to plough back in the industry or to repay the advances obtained. In fact the position is that if this corporation does not promptly and liberally help all the Jute and Cotton mills requiring assistance for modernisation and renovation, it is feared that the running of many of them will become uneconomic and they will be closed, bringing about reduction in the total production, when the country requires much larger production.

Another, task entrusted to N. I. D. C. is developing capacity for heavy machinery.

**Refinance Corporation for Industry Private Ltd.** The Refinance Corporation has been set up to provide re-lending facilities against medium term loans given by selected scheduled banks to medium-sized industrial concerns for increasing their production. The

present paid up capital is Rs. 2.5 crores. The Governor of the Reserve Bank is the Chairman of the Board of Directors. There are three more directors from the Reserve Bank of India, State Bank of India and the Life Insurance Corporation and the participating banks have three directors. The funds for the operations of the Corporation will come from its capital and the counterpart funds lying with Government of India under American Public Law 480.

The participating banks will get re-finance against the loans made by them to industries. The smaller scheduled banks which have been really helping the small and medium sized industries have been excluded from participation and, therefore, of the benefits to be derived from the establishment of this corporation. The bigger banks in India, which have so far practically avoided giving medium and long term loans to industrial concerns, will take a long time to reorient their policies and to train their staff. It is, therefore, doubtful whether any useful purposes will be served by the establishment of this institution on the present lines.

**National Small Industries Corporation Limited :** This is also a Government-owned concern and Government can place the required funds at its disposal. The idea in starting this corporation was to make loans available to small-scale industries or even to individuals, undertaking engineering jobs with one or two machines. How and when small-scale industries will benefit by financial assistance is discussed in part III which deals with "Financing of Small-Scale Industries".

**Particularly large scope for Industrial Finance in India :**

An attempt to promote real industrial development in a country can succeed only if the Government of the country makes a conscious, determined and comprehensive effort.

It is a matter of record that certain industrially advanced countries had protected the industries at home by high tariff



walls, and had, where they had suzerain powers or political influence, not only discouraged the industrial development but had adopted measures which would ruin what industries had already existed in their dependencies. The industries in these advanced countries also had developed certain financial and commercial techniques by which they could combine and make it impossible for newly started industries in under-developed countries to continue in production for any length of time. These combines would sell their goods at very low rates in the countries where new industries were set up, and could recoupe the loss by selling their products at higher prices in the countries where no competition existed. When such was the position of the world trade, nominal protection, sometimes given by the foreign rulers to the indigenous industries in their territories, was practically nullified.

India's former rulers had no fiscal policy calculated to promote the growth of industries in India. On account of the clamour of the Indian public and public men, the Government of India did appoint a Fiscal Commission in 1921 and it recommended "Discriminating Protection", because India's case for Protection and organised development of industry could not be resisted.

Some of the members of the Commission,—Sir Ibrahim Rahimtoola, T. V. Seshagiri Ayyar, Jamnadas Dwarkadas, G. D. Birla and Narottam Morarji—wrote a Minute of Dissent. The first two paragraphs of their Minute of Dissent predicted almost correctly what would happen if the so called "Discriminating Protection", with all the powers in the hands of the Commerce Ministry were to be tried. The two opening paragraphs of Chapter I of the Minute of Dissent were:—

"The reasons which have moved us to write a dissenting minute may be stated in a few words:

- (a) The main recommendation has been hedged in by conditions and provisos which are calculated to impair its utility.

(b) In places the language employed is half-hearted and apologetic.

(c) We are unable to agree with the views of our colleagues on Excise, Foreign Capital, Imperial Preference and the constitution of the Tariff Board.

2. Our first objection is to the statement in the Report that "we recommend a policy of protection to be applied with discrimination along the lines of the Report". To formulate a policy in these words is open to objection because:

- (i) In the first place, it mixes up policy with procedure.
- (ii) In the second place, by emphasising the method of carrying out the policy, the vital issue of the problem is obscured.
- (iii) In the third place, it ignores the fact that every country applies Protection with discrimination suited to its own conditions.
- (iv) Fourthly, in our opinion the outlook of our colleagues is different from ours. We do not, therefore, feel justified in subscribing to the view that Protection should be applied with discrimination "along the lines of the Report."

In our opinion, there should be an unqualified pronouncement that the fiscal policy best suited for India is Protection".

The Fiscal Commission laid down three general conditions to be satisfied by the industry before Protection could be granted. They were:

(1) The industry must be one possessing natural advantages, such as an abundant supply of raw material, cheap power, a sufficient supply of labour, or a large home market. Such advantages will be of different relative importance in different industries, but they should all be weighed and their relative importance assessed. The successful industries of the world possess certain comparative advantage to which they owe their success. No industry which does not possess some comparative advantages will be able to compete with them on equal terms



and therefore, the natural advantages possessed by an Indian industry should be analysed carefully, in order to ensure as far as possible that no industry is protected which will become a permanent burden on the community.

(2) The industry must be one which without the help of protection either is not likely to develop at all or is not likely to develop so rapidly as is desirable in the interests of the country. This is an obvious corollary from the principles which have led us to recommend Protection. The main object of Protection is either to develop the industries which otherwise would not be developed or to develop them with greater rapidity.

(3) The industry must be one which will eventually be able to face world competition without Protection. In forming an estimate of the potentialities of this condition being fulfilled the natural advantages referred to in condition (2) will of course be considered carefully. The importance of this condition is obvious. The protection we contemplate is a temporary Protection to be given to industries which will eventually to be able to stand alone.

Since it was left to the Government of India ultimately to decide whether a particular industry had satisfied the condition and was really entitled to Protection, and the Government was lukewarm in promoting industrial development, only five major industries, Iron and Steel, Cotton, Sugar, Paper, Matches and a few minor industries viz. Magnesium Chloride, Plywood, Tea-chests and Gold-Thread received varying degrees of Protection during the inter war years.

Even the half-hearted Protection given to a few industries in the inter war years did help to promote industrial development in the country.

It was really the second World War that gave real fillip and opportunity for development of industries in India. The needs of the fighting services for cloth, shoes, tyres, dressing,

bandages, jute products, small arms, ammunition, were immense and urgent and India was the only place where these could be manufactured. The natural potential of the Indian industries came into play and to the credit of Indian entrepreneurs and industrialists it must be said that they coped with the huge war-time orders not only with the existing machinery but by using some imported and some improvised machinery. Of course many new industries had to be set up to fulfill the war-time contracts and Government had to give an assurance that those industries which were started during the war will be given Protection after the end of the war. The curtailment of imports on account of the war brought about a rise in output of industries like, glass, electric bulbs, fans, pharmaceuticals and drugs, surgical instruments and appliances, heavy and fine chemicals and many other industries catering to the needs of the civil population. Soon after India attained independence the Government of India, in 1948 came out with their Resolution on Industrial Policy which among other aspects of the policy stated as follows :

“ In the present state of the country's economy emphasis should be placed upon expansion of production, in particular on production of capital equipment, of goods satisfying the peoples' basic needs and of commodities for export ”.

“ The tariff policy of Government of India will be designed to prevent unfair foreign competition and to permit the utilization of India's resources without imposing unjustifiable burdens on the consumer ”.

Even if Government wants to give Protection, the degree of Protection has to be granted looking to the importance of the industry, the scope for the industry and the exact degree of Protection required to secure production of the high quality necessary. Government, in 1949 appointed a Fiscal Commission whose recommendations are comprehensive and are drafted with a view to bring about speedy industrialisation of India. The Tariff Commission as recommended by the Fiscal Commission in Chapter XX of their report is now functioning and attending to all matters regarding Protection to industries.



The growing development of industries has been accelerated by the recent stoppage or curtailment of imports. Development of industries in a country, and particularly a country endowed with natural resources, has far-reaching consequences on the entire population of the country particularly when, an under-developed country, mainly depending on agriculture, tries large scale industrial development commensurate with its area, resources, population and prospects. The agricultural produce, which has to be exported to pay for the imports of necessities of life, becomes available for feeding the population on a better scale. Handling or seeing machinery in operation, widens the vision of the people. Establishment of one industry leads to establishment of many other ancillary trades and industries and gives employment to more people in the urban areas. The better wages and salaries that can be afforded by industries, so established, help to raise the standard of living of a much larger population. The proof that the country is not backward and dependent on foreign countries for its ordinary necessities of life, removes the inferiority complex and spurs the people to ambitions in research, management and trade.

The following statement shows in columns 2 and 3 the production of the various industries in India in 1951 and 1957. The figures are taken mostly from the Reserve Bank of India Bulletin, December 1958. No figures are available in one place of the production of the industries that were in existence in India in 1939. The writer has collected from various sources the figures for the principal industries that were in existence in 1939. Where no figures appear against any industry in the first column that industry either was not in existence or the production was not appreciable. Figures for "Tea" for 1939 have not been available.

It is evident that many important essential industries have recently been established in the country and production of the industries that existed in the country before the war has expanded many fold. The production of old and new industries is confidently expected to rise to new heights, as they get into stride.

The growth will have to be tended carefully by experienced hands otherwise the new plants will wither.

Item :	Unit :	1939*	1951	1957
		( Annual Total )		
1. Coal	000's tons.	333,24	343,08	435,00
2. Iron Ore	000's tons.	** 15,95	36,60	46,20
3. Sugar	000's tons.	6,96	11,16	20,04
4. Tea	00,000's lbs.	..	62,88	67,32
5. Salt	000's Mds.	446,52	743,76	987,00
6. Vegetable oil products (Vanaspati)	tons.	..	1,723,20	3,013,56
7. Cigarettes	00,000's	..	2,144,88	2,889,24
8. Cotton Textiles				
(a) Yarn	00,000's lbs.	126,48	130,44	177,99
(b) Cloth	00,000's Yds.	411,60	407,64	531,72
9. Jute Textiles				
(a) Hessain	000's tons.	4,92	3,24	4,20
(b) Sacking	000's tons.	6,36	5,16	5,52
10. Footwear (leather)	000's pairs.	..	57,12	74,04
11. Paper & Paper Board	tons.	666,00	1,319,16	2,101,32
12. Footwear (Rubber)	00,000's pairs.	..	2,28	3,72
13. Tyres (Automobiles)	000's	..	8,76	9,96
14. Paints and varnishes	tons.	330,00	334,92	422,76
15. Matches	000's Cases.	22	5,76	5,76
		(millions gross)		
16. Soap	tons.	..	834,36	1,116,00
17. Glass & Glassware (sheet glass only)	000's Sq. ft.	..	110,88	542,28
18. Cement	000's tons.	17,16	31,92	56,04
19. Ceramics (refractories)	000's tons.	..	2,40	3,72
20. Iron & Steel				
(a) Pig iron & ferrow alloys	000's tons.	17,52	18,24	19,08
(b) Finished steel	000's tons.	7,80	10,80	13,44
21. Non-ferrous metals				
Brass (sheets & circles only)	tons.	..	112,32	117,84
22. Gold	Fine ounces.	37,741,80	2,263,68	1,791,96
23. Hurricane lanterns	000's	..	39,72	43,44
24. Enamel ware	000's Pieces.	..	81,36	141,12
25. Automobiles	Nos.	..	222,72	319,22

\* Including Pakistan.

\*\* Figures from Tisco's 52nd Annual Report



The Prime Minister drew a correct picture of the large development of industries that is going to take place in India, when he said that the broad pattern of industrial development that he and his government envisaged included the growth of hundreds and thousands of enterprises within the broad frame-work of the Plan ( Times of India 9-7-1959 ).

No factory can produce everything under its roof. It has to depend on many other bigger or smaller factories to supply them parts or components and replacements. Setting up of new factories, therefore, leads to the establishment of many more factories.

Besides the scope offered for extending medium and long term finance for new industries, there are further opportunities for accommodating industrial units, which will be purchasing machinery to replace the worn out and obsolete machinery in the older industries in India. In the case of the Cotton Textile industry the heavy arrears into which the plant rehabilitation and modernization has fallen, came to light in the partial survey undertaken by Technical Sub-Committee of the Working Party for the Cotton Textile Industry (1952). Of the 91,898 looms inspected in 111 mills, 45,393 had been installed before 1910, 23,375 during 1910-25 and 23,130 after 1925.

The banks in India will have to play their part in meeting their requirements of finance both for day to day working, against raw materials and finished products and for short and medium term loans against fixed assets. India is trying bifurcation of these two financial services by making the industrial units go to specialised industrial finance institutions for their medium and long term requirements and asking the banks to stick more or less to extending finance only for their day to day requirements ( working capital). This division might not cause hardship in case of bigger companies taking large loans, but it will not work in case of smaller industries and the banking practices will have to follow the American model. Every commercial bank will, therefore, have to take more and more interest in accommodating industries for both their working capital and short and medium term requirements. The sooner, therefore, they begin to handle this line of business the better it will be for the country. The scope is tremendous.

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## CHAPTER III

### FORMS IN WHICH ASSISTANCE IS GIVEN

Commercial banks generally look to the security and give assistance mostly against hypothecation or pledge of goods or documents of title to goods and only occasionally in the form of loans on mortgages or debentures, but the companies borrowing for their long-term needs of industrial finance will require assistance in different forms according to their status, standing and in case of smaller companies, according to their ability to bear the burden of interest charged until the expansion scheme was working in full swing.

#### Loans on Mortgages or Debentures Covering Company's Fixed Assets :

Assistance in this form will be given in simple cases where there is enough margin, between the amount to be lent and the total value of the existing fixed assets plus the assets to be acquired with the amount lent.

Though debentures are a form of mortgage, all mortgages are not in the form of debentures.

A mortgage is a charge which a borrower gives to a lender upon a part or the whole of his property.

There are two kinds of mortgages :

1. Legal mortgage.
2. Equitable mortgage.

*Legal Mortgage*, if suitably drawn-up gives the mortgagee the right to sell the mortgaged property without the intervention of the court, e.g. English mortgage which can be created in India in the towns of Bombay, Madras or Calcutta or mortgage by conditional sale, which can be created in most parts of the country. The mortgage deed contains all the terms on which the advance is made.



*Equitable Mortgage* gives no legal estate to the mortgagee. It gives him a charge on the land, an equity in the shape of a right to enforce his right with the aid of the court.

Industrial finance institutions do not give long term loans against equitable mortgage but might, on rare occasions, make a small part of the long term loan available against equitable mortgage for a very short period to meet urgent liabilities.

*Debentures* are acknowledgements of indebtedness reciting the charge on the assets of the borrower company. They may be issued for one lump sum or in a series of say, Rs. 1,000 each, in which, each one of the series is expressed to rank *pari-passu* with the others.

Debentures may be redeemable at a stipulated time or after a certain period of notice.

Debentures are scrips like shares, issued in terms of the trust deed executed by the company. The trust deed prescribes the conditions on which the assets are mortgaged and names of the trustees who, in law, hold the assets mortgaged, in trust for the debenture holders.

A creditor taking a legal mortgage has to find a buyer to purchase the entire property mortgaged. A creditor, holding debentures issued in a series, can sell any number out of the series at his convenience and get back that part of his funds.

The negotiable character of the debentures some times makes the borrower give a mortgage instead of debentures. The borrower fears that the lender might sell the debentures and rivals or competitors might buy them and put the screw on him for the slightest breach of the terms.

It is worth remarking here that the mortgage or charge on a ship or steamer is created by special kind of documents.

### **Subscription Towards Capital :**

No one likes a mortgage on his property. Every company will ask that the assistance be given by way of subscription to the share capital of the company, and preferably by subscription to the equity capital that is, ordinary share capital. I

the assistance is by way of cumulative preference shares the company will have to make provision for the fixed interest. In the case of ordinary shares they are not required to pay any dividend on the shares until the company makes enough profits to be in a position to pay the dividend and are relieved of the interest charge, which a mortgage of the property or issue of cumulative preference shares will entail.

Ordinary shares in the company issued to the financiers or financing institutions do not create any security in favour of the lender. Assistance by way of subscription to the company's capital is therefore, given only in few cases with certain safeguards. Institutions like the Industrial Finance Corporation of India, which carry liability in respect of the guaranteed dividend on the share capital and have to raise funds from the market at high rate of interest for their operations, cannot afford to help by taking up ordinary shares for the reason that the investment in ordinary shares might not bring any return for 6 or 7 years, while interest on funds borrowed will have to be met punctually.

#### **Guarantee given where Machinery purchased on Deferred Payment Terms:**

Where a country's balance of payment position is unsatisfactory – i.e. when the payments to be made by the country for imports from, and services rendered by, other countries, far exceed the amounts to be received from other countries for the goods exported and services rendered by the country—the country naturally puts restrictions on imports, thus reducing the amount to be paid to foreign countries. But if the country is at the same time anxious to promote industrial development and manufacture, in the country, of the articles, the imports of which are causing a strain on the balance of payment position, the country must allow new industries to be set up.

These new industries are however required to import machinery from foreign countries and this contributes to increase the liability to the foreigners.

Some Governments facing balance of payment difficulties compel the new factories, importing machinery from abroad, to ask the foreign suppliers to take part of the price immediately to accept



the balance in two, three or more years. Such Governments fail to realize that obtaining machinery on "Deferred Payments" terms involves the country and the industry in heavy losses and increase the Foreign Exchange risk to the industry. The foreign sellers naturally add heavy interest charges, quote higher prices and insist on guarantees from good banks to ensure eventual payments.

If the fixed assets of a company are mortgaged to a financial institution for industrial finance then the banker, who is financing the company against raw materials and finished products, will not give a guarantee for Deferred Payments. The industrial finance institution, therefore, will have to give the guarantee to the sellers of the machinery. There is not much risk in giving this guarantee. If a company has land and buildings worth Rs. 15 lacs and is importing machinery worth Rs. 75 lacs, it would in the ordinary course get a total advance of Rs. 45 lacs, i. e. equal to 50% of the aggregate value of the land and buildings. The company will have to find Rs. 30 lacs from its own resources. In case the company enters into a Deferred Payment arrangement agreeing to pay 50% cash down and the balance, say in three years, it will be required to pay immediately Rs. 37.5 lacs to the foreign manufacturer of the machinery. Since the company has to find Rs. 30 lacs it will be borrowing from the financial institution only Rs. 7.5 lacs. The lender will have to give the guarantee for deferred payment of Rs. 37.5 lacs. The company's indebtedness to the lender will be Rs. 7.5 lacs and the lender will have a security amounting to Rs. 52.5 lacs (existing Rs. 15 lacs + part price paid Rs. 37.5 lacs). The lender will have incurred a liability for Rs. 37.5 lacs, (the balance of the payment on the machinery) for the guarantee given to the supplier of machinery. If the lender is at any time called upon to pay the balance of Rs. 37.5 lacs, the value of the mortgaged security will amount to Rs. 90 lacs (Rs. 75 lacs, fully paid for machinery plus Rs. 15 lacs buildings) and the company's indebtedness would have gone upto Rs. 45 lacs (Rs. 7.5 lacs previous balance plus Rs. 37.5 lacs, the remaining payment on the machinery). The total loan to the company will, therefore, not exceed 50% of the value of the assets mortgaged.

**Help given against Raw Materials/Finished:**

It is no doubt the banker's business to extend help to manufacturing concerns against raw materials and finished products but, in unusual circumstances, the financing institution extending industrial finance, is also required to help a borrower by extending accommodation against raw materials and finished products. Industrial finance is made available to industrial concerns on the estimates of their prospects under certain circumstances. If, for any reason, circumstances change, the long term lender has to nurse the borrower. For instance, if a sound company, enjoying the best of relations with its bankers with whom it has cash credit arrangement against raw material and finished products, had borrowed against fixed assets from an industrial finance organisation for expanding its production, was faced with a serious collapse of sales on account of the government having allowed unlimited imports of the type of article manufactured by the company, it would have no other alternative but to close down the factory, unless the banker agrees to increase the factory's cash credit limit against raw materials and finished products to take care of the mounting stocks due to lack of sales. If the banker refuses to increase the limit, particularly after the company had, in the meantime, mortgaged its "Second Line of Defence",—its fixed assets—to another institution, he could not be blamed.

The institution holding the mortgage over the company's fixed assets should enable the company to keep on running. It should grant an additional loan against raw materials and finished products, in the hope that the depression in sales caused by the heavy imports will soon be lifted. The company will soon attain its normal sales volume and will be able to repay the additional advance and will later work within its limit with the bankers.

It will not pay any manufacturing concern to take a loan against raw materials and finished products, and it should not be the policy of an institution handling purely industrial finance, to extend help against raw materials and finished products, except in special circumstances and that too for a limited period of time.



**Finance Against Large Export Orders :**

In advanced countries the industries sometimes secure large orders for their products like locomotives and aeroplanes. On the receipt of the orders they have to plan starting the production. Sometimes they even have to expand their factories. Large amounts are also urgently required for buying raw materials components etc., but the products are not ready for delivery even after 12 months. In such circumstances, the industrial concern requires large finance, which is extended through special financial institutions set up or formed for this purpose, e.g. the Export Import Bank in Japan, and the Air-Finance Corporation Ltd., in England.

**Underwriting :**

Underwriting of shares is not a direct loan. It is a form of assistance which guarantees so much permanent capital if the public fails to respond eagerly.

Serious failure of an "underwritten issue" might create difficulties for the underwriting broker. In the case of a financial institution it indicates poor judgment, unless the risk has been knowingly taken in view of the assured prospects of the company and temporarily depressed condition of the stock exchange, at substantial commission. If the risk is good, the shares are soon taken off the hands of the underwriters, sometimes at a premium. This is as it should be.

Underwriting is therefore done in case of companies with assured prospects and highly respected management.

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## CHAPTER IV

### FINANCING INSTITUTIONS' SCRUTINY OF APPLICATION

#### Scrutiny Covers many Aspects:

Industrial enterprises when they require medium or long term finance for expansion generally prefer to have it from their bankers who have known them for years and are already in possession of most of the information about their capacity, integrity and resources.

In the countries where the bankers are not allowed to transact this type of business or do not want to handle it as a matter of policy, the industrialists have to have recourse to institutions specializing in industrial finance or have to approach the public through the stock exchanges. New companies require this kind of finance, when they find that on account of circumstances beyond their control the share capital already collected by them or likely to be collected by them, in view of the condition on the stock exchanges, will not be adequate to meet the increased expenditure on machinery, building, etc. Some borrowers want to keep the paid-up capital low. Old companies are in need of funds for renovation, modernisation or expansion of their factories. Sometimes they want to start an affiliated company to take up a completely new line of production.

Long-term finance is extended mainly on the basis of the scheme put forward by the company and the prospects of the scheme working successfully. Sometimes it takes one or two years or even longer, in a country like India, where the machinery is to be imported, for the scheme to get into operation. Even after the factory starts working satisfactorily, some shortages may develop and certain difficulties might be experienced in the working of the scheme, for instance some raw materials to be imported from foreign countries may not be available at all or in adequate quantities. This will make the factory work shorter



hours and show loss. The company may not get, for some months some of the necessities, like coal or raw materials. The factory may have to close down for lack of these things, and may, on account of the losses incurred, lose some of its working capital. There will have to be perfect understanding between the financing institution and the borrowers, by which the borrowers will keep the lenders informed of their difficulties, and lenders will by representations to the authorities and through their connections with other industrial concerns, try to help the borrowers to get many things, of which, they may be running short.

If the working capital is lost to a certain extent, the lenders may have to grant additional loans to the borrowers where the scheme is intrinsically sound, management efficient and competent, and there is an assured market for the products once they come on the market in adequate quantities.

In short, helping by industrial finance is like planting a tree, and it is not necessary to dig up and examine the roots when the examination of the part above ground gives sufficient indication of the tree's health. Patience, sympathy and understanding on the part of the experienced top executives of the lenders will help many borrowers to overcome their difficulties.

Most of the financial institutions handling industrial finance employ staff who know, or are capable of understanding the working of industries because, without it, they would be like doctors who have no knowledge of anatomy and physiology.

The Encyclopaedia Britannica gives, in brief, a comprehensive idea of the working of practically all industries, the processes employed, the raw materials used, machinery required.

### Visits to factories:

Top executives of lending institutions get a clearer picture of the good and bad points of a factory if they personally inspect the progress of the scheme on the site of a new factory and study on the spot the working of an old factory.

With first hand knowledge of the several factors—particularly favourable factors—they can handle the problem of the factory with courage and understanding.

*Bankers better placed:* The bankers who have handled the business of the promoters for years and had opportunities of watching their dealings and progress are in a better position to judge their capacity to make a success of the scheme put forward.

*Applications from New Concerns:* Proposals from new concerns present certain difficulties which are not experienced in case of old established concerns.

Sometimes the promoters have not run big industries before, and apprehensions are likely to be entertained about their ability to handle a business of the type or of the magnitude proposed. The scheme will have to be examined to see whether they have paid careful attention to all the points detailed in Part I, Chapter III. Not only should the directors of the lender, having experience of that type of industry, go through the scheme carefully, but where the amount involved is large and the industry is of a new type, it should also be got examined by an expert in the line or a committee of experts. As the success of the scheme will depend more on the honesty, integrity, and capacity of the promoters or the management, full information will have to be obtained about them by making enquiries of their bankers. If the promoters have been handling any other industries, information gathered about the success, if any, achieved by them in those industries, will strengthen their case for assistance. The previous balance-sheets of the companies already under the management of the promoters, will reveal whether they are real industrialists, or are merely adventurers, who are out to make money for themselves out of the concern as profits come in on account of fortuitous circumstances, and never pay attention to ploughing back the profits to strengthen the company.

The banker or financier, with his experience of financing industries, which has also given him the ability to assess the merits of a company from the balance-sheets will, at a glance known whether the scheme has been prepared with the thoroughness and accuracy demanded.



*Prospects of Scheme put forward:* The picture of the future of the company can be drawn from the data supplied.

The data must cover:—

1. A detailed estimate of one year's production with costs for each of the items like raw material, labour, essential services and overheads.

2. An estimate of the total quantity of the production expected to be sold, the price expected to be realised and information about the prices for similar items charged by indigenous manufacturers or importers.

This estimate must show real and careful study of the position, and chances of imports, supplies available in the market from competitors, and duties, if any, levied by Government.

3. The estimate of profit after deducting the cost of manufacturing and liabilities like selling expenses etc.

4. Repaying capacity after meeting depreciation, fixed interest on capital, dividend to be paid etc.

These estimates should be projected over three year's working.

If scrutiny reveals that the estimates are far from realistic it would be advisable to avoid lending to a borrower who could not even take pains to prepare fairly competent estimates.

If the amount of the loan asked for is disproportionate to the resources of the company and the details vague, the application can be rejected straight-way, because it will show that the promoters have no sense of proportion and are approaching for assistance only to get a large sum of money, without stopping to think how anybody would give them such a large amount without any definite ideas as to what exactly they are going to do with the money.

India had very few industries before the Second World War. Some new industries developed on account of the encouragement given by War-time conditions when any one who had some machinery could make money. The result of this has been that

most promoters do not realise what detailed planning is necessary before a scheme is put into operation, and what standards of production, efficiency and honesty they must maintain to be successful industrialists.

Some factories, asking for disproportionate financial assistance, may also have good schemes, which could be worked in stages. With proper advice, the borrowers should be able to do well on that part of the scheme, which they can work within the help that the financial institution can give them. In curtailing the scheme or reducing the amount of the loan, two things have got to be remembered.

1. The scheme, when curtailed, should not become uneconomical, for instance, if a cotton mill company wants to put up a cotton mill with 50,000 spindles, and if they are asked instead to put up a mill with 25,000 spindles, the smaller mill will not be uneconomical. But if any borrower suggests that if a larger sum cannot be lent he would instead, with a smaller loan set up a mill with only 5,000 spindles, the idea would not work because a mill with 5,000 spindles would not be a paying proposition.

2. A cement factory with an annual production of 50,000 tons of cement requires say a capital of Rs. 1,25,00,000/-. The company has collected Rs. 50 lacs. If they come forward with a proposal for borrowing Rs. 40 lacs on the security of the buildings worth Rs. 20,00,000/- and the machinery worth Rs. 20,00,000/-, which they already have, and the machinery worth Rs. 40,00,000/- which they will be purchasing out of the Rs. 40 lacs, the proposition will have to be rejected because the scheme itself requires in all, a capital of Rs. 1,25,00,000/-. The company, even with financial assistance of Rs. 40 lacs, will have only Rs. 90 lacs. It will be short by Rs. 35 lacs, and this lack of funds will make it impossible for the factory to work satisfactorily and to repay the loan raised.

*Applications from Established Companies:* Established companies applications usually show that their schemes are prepared with thoroughness, and that they have themselves given all the important information likely to be required. Their applications generally cover their needs for modernisation, i. e. replacing old



machinery by up-to-date machinery, renovation, i. e. replacing only parts of the machinery, and making it more efficient, expansion, i. e. increasing the production to meet the increased demand for the product.

The past record of these concerns, as seen in their balance-sheets, reveals the progress they have made inspite of the set-backs they might have suffered on account of temporary difficulties created by Government's action, or acts of God and on account of changes arising out of disturbances in the international situation.

*Processing the Application:* The applications for industrial finance are required to be submitted on the special standard forms of the financial institution. These generally require information on several points like:—

1. History of the company.
2. Capital structure of the company.
3. Any associated companies?
4. Standing of the Directors and the Managing Agents.
5. The borrowings against debentures or mortgages.
6. Cash Credit arrangements and borrowings from banks.
7. Amount of loan required, and the period of repayment.
8. Balance-sheets.
9. The Scheme.
10. Estimated liability for income-tax.

### **Inspection :**

When the cursory scrutiny of the application, in the office shows that the application has fairly good chances of being accepted, the financial institution sends out its own inspector to visit the concern and to verify and comment upon the information given by the company in the application. Many favourable and unfavourable facts not apparent in the application, come pointedly to attention in the inspection report. A digest prepared from a large number of reports might run as follows:

### **Points in Inspection Reports, Requiring Attention :**

*History of the Company:* As supplied by the applicant, the history is generally very brief, and does not bring out many

important points. In the case of some companies, it is possible that when the inspector looks deeper into the records of the company, he might come accross instances where most of the capital of the company is held by one family. He might even find that the Managing Agents had, while the company was doing well, not only not taken the ordinary precaution of building up a reserve fund for replacement of the machinery, which was bringing in large profits though it was being over-worked, but had actually refunded a part of the original capital to the shareholders, mostly members of the family.

*Capital Structure of the Company:* In considering the capital structure of a company, the issued, subscribed and paid-up capital gives the real indication of the actual capital collected. The authorised capital only indicates the extent to which the company is authorised to raise the capital. It may raise the capital to the extent authorised, very soon or not for years. Very often the figure is so large that there is no chance of the company ever being able to raise capital to that extent.

Where the paid-up capital is made up of cash subscriptions it indicates a healthy sign, but where it is swollen by shares issued by revaluing of the assets of the company, the lender has to be very careful. Take for instance, the case of a particular company. Their land stood in their books at Rs. 2 lacs, their machinery at Rs. 5 lacs. One fine morning the company got someone to revalue the assets of the company and on the strength of his report, increased the value of the land to Rs. 12 lacs and the value of the machinery to Rs. 40 lacs, and issued new shares for Rs. 45 lacs, thus increasing the paid-up capital by Rs. 45 lacs.

In the case of smaller, new companies, it is not rare to find that the Directors and Managing Agents were in arrears and had not paid the calls on the shares taken up by them. Obviously, the directors or managing agents did not either have the resources or the confidence in the future of the concern, and therefore, had no stake.



*Security for the Loan:* The security for the loan generally consists of the existing assets of the company and the assets to be acquired, built or purchased with the amount of the loan the company is seeking. When the existing assets are inspected and the records scrutinised for examination of the title to the land, and to verify the amount actually spent on land, building, plant and machinery etc., many interesting facts come to light.

(a) *Land:* On account of the complicated laws of succession in India, and the diversities of the laws governing many communities, examination of title to the land is always a complicated and taxing job, but since the title to the building, plant and machinery erected on the land, is dependent on the title to the land itself, great care has to be taken in investigating the title to the land.

The balance-sheets of a company showed building plant and machinery valued at Rs. 60 lacs, but no item entitled 'Land'. It was presumed from the study of the balance-sheet that the land was leasehold and that the company was paying the lease rent. It is reported that on actual examination, it was found that the land belonged to one of the partners of the managing agency and he had not cared to transfer the ownership of the land to the company. It was wrong of the auditors to have accepted the building and machinery on the land as property of the company when the company had no title to the land.

Another instance had come to light where the managing agents bought a large piece of land and divided that land in two pieces, one for company A and the other for company B. The pieces of land were formally transferred to each of the companies. But no attention was paid to the exact area belonging to each of the companies, and part of B's factory building was constructed on A's land. Unless a survey is made to verify the plot on which a factory is situated, it is not possible to ensure that the factory had not been built on somebody else's land. But in case of this company, it appears it was discovered earlier by one of the companies, and company B was paying rent. When the inspector found that a large amount

was being paid by way of rent, even though the company actually owned the land according to their statement, he went deeper and found that someone had discovered that this factory had built, at least a part of their factory, on land not belonging to them, and was made to pay heavy rent for this portion of the land.

In another instance, an established company had started an affiliated company and the affiliated company's factory was built in the compound of the old factory, without any land being specifically assigned or sold to the new company. The new company had no direct access to the road. They were supplied electricity from the generating equipment of the old company. Since the old company was not borrowing, it was impossible to lend to the new company, which had no independent land of its own, no direct access to the road, and were entirely dependent upon the parent company for electric supply.

(b) *Building*: In one case, on seeing the buildings actually standing, and comparing the costs debited to the building account, it appeared that the cost debited was disproportionate. On inquiry it was found that the company was not maintaining regular accounts and the cost shown against building was certainly two or three times the normal cost.

(c) *Machinery*: It was once found that the company had not disclosed that they had bought old, second-hand machinery, and were giving the impression that the company had machinery worth lacs of rupees, whereas in fact it could not have fetched even one-tenth of the price shown in the company's balance-sheet.

(d) *Building and Machinery*: A peculiar instance came to light in one case where the company was, for the purpose of the balance-sheet, debiting their profit and loss with depreciation at normal rates, while at the time of the income-tax assessment they were claiming initial, extra and multiple shift depreciation, allowed under the Income-tax Act. The actual depreciated value of the building and machinery therefore, differed from that shown in the balance-sheet. Of course, this was legal, but the lender should have been appraised of the position. He would then have known



what depreciation allowance the company could get and whether it would, be in a position to repay the loan.

*Other Liabilities:* It is often found that though the company has heavy liabilities like arrears of bonus, or wages they do not show them prominently in their balance-sheets. The total liabilities of the company should be carefully looked into. The company might also suppress heavy losses they may have suffered on speculative purchase of raw materials.

*Debentures:* A certain company had issued debentures of the face value of Rs. 2 crores to the public and Re. 1 crore to their bankers for cash credit arrangements. The total block was Rs. 5 crores. The burden of existing debentures was therefore rather high compared to the value of the assets of the company. The company tried to justify it on the grounds that the present value of the machinery was at least of Rs. 10 crores.

On account of the rise in prices of machinery and the difficulties in securing import licences on account of shortage of foreign exchange, the replacement costs are often many times the book values of used machinery. However high the replacement value, the industrial finance institution should be guided by the cost less accrued depreciation. Replacement value is not the same as resale value that could be realised over a period.

*Investment:* In one instance a company wanted a large advance of Rs. 50 lacs. They had fairly good security to offer, but it was found that the large profits they had made during the war had been invested in purchasing shares of other companies under the managing agency of the same managing agents, and had invested a very large sum in providing a palatial residence for the chairman of the company in one of the best localities of the city. It was not fair on the part of the company to ask for finance when they had locked up their liquid resources and reserves in unnecessary and unconnected investments.

Another company was found to be running several factories besides the two principal factories mentioned in their application. It was found that two of these were not running profitably and their losses were absorbed by the profits of the bigger factories,

which were doing well. Such a drain on a borrowing company is not desirable, and they should be asked to close down the smaller factories which are not likely to run at a profit.

It was also found that they had machinery for a small soap factory, lying unpacked, and they assured the inspector that they had no intention of diverting their energies towards running a soap factory, which they knew would not be paying.

*Loans and Advances to Others:* A loan for a large amount was outstanding against a coal mine formerly worked by the company, but which had since been sold to an associated firm owned by some of the partners of the managing agents. It appeared that the partners of the managing agents were deriving the benefit of ownership of the coal mine without having invested their own funds and were making profits from the coal supplied to the previous owners, the applicant company.

*Arrangement with Banks:* In one case it was found that the bank was pressing the company to take delivery of the large quantities of chemicals pledged with the bank because the chemicals had deteriorated with storage, as the company's production was very small.

*Analysis of Balance-sheets:* In some cases a study of the balance-sheet and profit and loss account of the company, for the previous three or four years, brought out the following points :—

(1) The fixed Assets were standing at a comparatively low figure, because the company had purchased an old factory which had not given satisfactory production for years.

(2) The company's financial resources for working capital had been wiped out by continuous losses for three years and it was able to carry on with the large deposits the selling agents had given to secure the sole selling agency. The sole selling agents were entitled to exorbitant commission.

(3) The company was showing losses for two years by undervaluing the stock to suppress profits.

(4) The company was paying dividends though profits could not cover usual depreciation.



(5) The company's expenditure on coal was rising higher and higher for three years though production was going down. The quantity consumed was practically the same. The average price paid, when worked out was four times the market price.

(6) The company had invested large sums in Government Securities at par. The price had gradually come down to Rs. 84/- per hundred. The company having lost the earlier opportunity of cutting their losses was obstinately sticking to the investment earning 3% p.a. and borrowing against it at  $4\frac{1}{2}\%$  p.a.

*Associated Companies:* When there are associated companies, the connections and transactions between the companies require to be looked into, because it is often found that capital of the applicant company is made up by the affiliated companies taking the shares, or the company expects to have its working capital through loans from the affiliated companies. Sometimes there is a lot of inter-locking: if A and B companies are associated, company B takes up part of the paid-up capital of company A, and company A takes up capital of company B. Though both the companies secure the capital in this way, that part of the capital which is inter-locked is useless to both the companies.

Having associated companies is advantageous in some respects. An associated company can either use the production of the parent company, or supply it with the parts or components it requires.

What should be avoided in associated companies is extensive and complicated lendings and investments in each other's shares. The subscription to shares of essential associated or subsidiary companies must come from surplus built out of profits. It must not strain the already slender resources of a company.

*Standing and Capacity of the Directors and Managing Agents:* Though the Directors, as a board, and the managing agency firm as a whole may enjoy a very good reputation, it is sometimes found, during inspection, that one of the directors is unnecessarily creating difficulties or one of the partners in the firm of managing agents is pushing his own ideas, however wrong, and is trying to

ride rough-shod over the decisions of the senior partners who may not be on the spot. Particularly troublesome are the persons, who get into the managing agency through some pressure brought on the managing agents. These persons have not enough stake in the fortunes of the managing agency firm or the company managed, and prove a very disturbing factor.

*Cash Credit Arrangements and Borrowing from Banks:* Every factory, working on a fairly large scale, must have cash credit arrangements with its bank to cover the stocks of raw materials for 3 to 6 months, which it may be required to keep on hand and to take care of the finance that may be required for holding the finished products until they are sold and delivered. The arrangement must be large enough also to take care of the company's need for finance if there is a set-back in sales. In the case of a company already in existence, its past records show whether the company has been comfortable in the matter of working capital and whether the bankers are satisfied with its dealings.

Inspection had disclosed that a new company had not succeeded in arranging for cash credit facilities from its bankers before starting the factory and an old company planning expansion was still negotiating for enlarged cash credit facilities with its bankers.

*Amount of Loan Required:* Sometimes companies deliberately under-estimate the amount of the loan required. There are others which over-estimate. Careful inspector sometimes finds that the company had underestimated the amount of the loan required and was, because of higher prices they had to pay for the machinery, trying to avoid purchasing some important machines.

The inspector may also come across a company trying to purchase machinery which it can do without, at least for sometime, until it was doing well and was in a position to bear a larger load of debt.



It is in the 'Buildings' item that they either try to underestimate, only to keep the amount of the loan within the figure that they think the lender will give, or over-estimate their requirements, only because they are getting a loan, and try to put up extra-large factory buildings. Both practices are not desirable. If the required buildings are not provided, and the factory is cramped, the working will not be efficient. On the other hand, sinking more money in the building than is absolutely necessary is also a wrong policy, because if there is scope for borrowing more against the building and machinery that margin should be reserved against contingencies.

*Ability to Repay:* The calculations regarding the repaying capacity of the borrowing company are based on the company's estimated cost of production and its ability to sell the product in adequate quantities at certain assumed prices. The calculations might be correct at the time they were made on certain assumptions. But the inspector might find that the only competitor who was not expected to be in the field for two years had vigorously pushed the execution of his scheme quietly with foreign collaboration and was going to put the article on the market very soon, and the borrower, whose progress had slackened on account of internal dissensions, was going to find it difficult to get a footing in the market, after the competitor had established himself on the quality of his products. The total production of both the factories might exceed the demand and the prices realised will be lower than those expected by the borrower.

These developments reported by the inspector will require a serious review of the applicants' capacity to repay.

*Taxes:* It is the duty of the inspector to see that there is no draft on the profits of the company for items like purchase tax, sales tax, local bodies' taxes viz. octroi etc., which being local, are not apparent in the application, and are over-looked in estimating the capacity to repay.

*Scheme:* The inspector has to scan the company's records and find out whether all negotiations are going on smoothly for putting the scheme comfortably into effect at the earliest.

*Estimated Liability for Income-Tax:* New companies, of course, have no liability for income-tax, but in case of old companies, the borrowers must be made to produce evidence to show their last assessments for the year for which they have been assessed, and get their auditors' certificate for the estimated liability for the remaining years until the current year. If the company has sufficient profit earning capacity to meet the expected liability, or if the amount already paid in advance under income-tax rules is enough to cover that liability, it is a healthy state of affairs.

Unfortunately, in India the Central Government can have a charge on the assessee's assets for arrears of income-tax, and the lender, if he grants the loan without ascertaining the liability of the borrower for income-tax, might find his own security attached, and sometimes sealed by Government.

*Technicians:* In the case of a company which was handling a type of industry new to India, the technical experts who had started producing first-class products, had left the company, and the company, was not able to produce articles of quality.

In another company it was found that though the company had mentioned in their application that they had arranged for technical experts to arrive before the factory started working, the correspondence showed that somebody in the management, who had vain and exaggerated ideas of his own capacity to handle production, was trying to see that the foreign experts were not engaged.

*Dropping parts of a scheme:* In one case, when the inspector stayed at the factory for some days and tried to find out the details of the scheme the company was going to work, he discovered that the company had dropped some part of the scheme, for financing of which it had asked for assistance, and was going to work only a part of the scheme. This would reduce its capacity to repay.

*Transport:* A visit to one factory showed that they were situated away from the main line, and were dependent for their transport on the private railway line of a neighbouring competing company.



*Water:* In one case the inspector discovered that the original statements made by the company in their application, that they can have enough water from the wells in their compound, was totally incorrect. The wells were not likely to give even 1/100 of the quantity of water required, and one of the partners of the managing agency firm was quietly putting a dam on a nearby river building a huge reservoir on his private land, and was intending to sell the water to the company's factory. This was most unsatisfactory, because if the company failed, the partner of the managing agency could hold the buyer to ransom because he would be controlling the only possible and available source of water, which was required in large quantities.

*Effluent:* At one of the factories making caustic soda it was found that they were having trouble with the municipal authorities, and Government departments because the effluent from the mills, carrying remanants of injurious chemicals, was let out on the surrounding lands and was, it was alleged, being absorbed by surrounding agricultural lands and wells. A paper mill was facing similar allegations.

### **Certain Outstanding Good Points in Reports:**

Though many inspections brought out certain adverse factors, which required to be straightened out, it was a pleasure to come across some reports which emphasised :

(a) The scrupulous honesty with which the accounts were maintained.

(b) The care and scrutiny expended in securing the best and most up-to-date machinery.

(c) The excellent system devised and worked to keep the top management posted about the day to day working of all the departments.

(d) The efficient manner in which the records were kept and the promptness with which all correspondence was dealt with without over looking any point.

(e) The special attention paid to proper economy and avoidance of waste, first in erecting the factory and later in running it.

(f) The dynamic energy displayed in keeping abreast with the latest researches and developments in the industry in the world.

(g) The manner in which modern methods of Time and Motion Study, Statistical Quality Control and Cardex Recording etc. were being introduced.

(h) The detail and painstaking way in which Market Research was organized and exports to foreign countries increased by scrupulous adherence to contracts.

(i) The careful notes kept of all the complaints from the buyers of the products and the pains taken to remove all causes of their grievances.

The consciousness that the neglect of the buyer and turning a deaf ear to his complaints, was the sure road to ruin, was amazingly well realized by many progressive industrialists.

### Summing up Pros and Cons :

The information given in the application and the detail description of the scheme, help the lender to spot the strong and the weak points and to decide whether he will process the application further :

Certain points weigh in favour :

(a) The industry proposed to be established is one that will either replace large or vital imports or will help reduce the prevailing shortages in the country of important items like paper, sugar etc.

(b) The scheme is worked out with care and thoroughness and can easily be worked.

(c) The promoters have sufficient managerial ability and fairly good financial standing.

(d) Exceptionally convenient site, commanding cheap and abundant raw material in the vicinity, possessing more than adequate electric supply and water, and enjoying special advantages in distribution on account of a geographically central situation.



It is likely that there might be several drawbacks :

(a) The loan asked for might bear a slightly higher proportion than usual, to their paid-up capital.

(b) It might be possible to have a smaller plant with lesser production capacity, without seriously impairing the profit earning capacity of the project.

(c) The security being ample for both, the consent of the persons holding existing debenture, repayable after some years, has to be obtained to give the new lender, if not a prior charge, at least a charge ranking parri-passu with theirs.

Some of the defects like low capital ratio need not be remedied immediately.

The fate of the application is decided after balancing the several factors and giving due weightage to important favourable points and overlooking minor unfavourable ones.

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## CHAPTER V

### LENDER'S DECISION ON THE PARTICULAR FORM OR FORMS IN WHICH ASSISTANCE WILL BE GIVEN

After the financing institution has decided to entertain an application for assistance, they have to decide the particular form in which the assistance will be either acceptable to the company in the particular circumstances, if it is a very strong company, or suitable, if it is a small company which has done excellent work in its field and has assured prospects.

In some cases, where a large part of the machinery is being imported from abroad on deferred payment terms, further assistance will also have to be given in the ordinary course, in the form of guarantee for deferred payments to the foreign suppliers of machinery.

Underwriting is not direct assistance or loan. It is a help. In case there is no satisfactory response to the shares of the company it amounts to putting additional funds at the disposal of the company.

The following hypothetical cases will illustrate why it was decided to give them assistance in the particular form.

*Company A : (Mortgage):* This company had existing fixed assets like, land, building, and machinery worth Rs. 2 crore, and out of the loan of Rs. 50 lacs they were going to utilise Rs. 40 lacs for purchasing new machinery. The company was therefore, offering total security worth Rs. 2,40,00,000. A loan of Rs. 1 crore against mortgage, to be repaid in 10 years, was granted to them because they were not willing to issue debentures.

*Company B: (Debentures):* It had assets worth Rs. 3 crores and wanted a loan of Rs. 75 lacs for expansion, to cover the cost of building and machinery amounting to Rs. 75 lacs. Therefore, the security would be Rs. 375 lacs. The company's position



was sound and the debentures of Rs. 75 lacs being very small compared to their large resources, the assistance was given by taking debentures.

*Company C: (Ordinary shares):* This was a small company, the proprietor of which had developed his factory from a small beginning and was now having fixed assets worth Rs. 3 lacs. He wanted a loan of Rs. 3 lacs for expanding his factory, but as he had explained that manufacturing of precision instruments, the line he was handling, required great skill, patience and accuracy, and any scheme in that line might take 2 or 3 years to fruitify, it was decided to give him relief from heavy interest charges and to extend him assistance by taking ordinary shares in the new company that he was forming.

His scheme was confidently expected to be a success. The country would be having a new and valuable industry. The investment in ordinary shares would in the long run, yield a better return than loan.

*Company D: (Preference shares):* The management of this company had an excellent record. This company also had assets worth Rs. 6 crores and they wanted to raise only Rs. 75 lacs. As their standing was very high, the amount required was small, and the company was running one of the pioneer industries in the country, it was decided to take preference shares, redeemable in 7 years.

*Company E: (Hypothecation of raw materials and finished products):* This recently established company was doing very well, but the Government's putting small h.p. electric motors on the Open General Licence, made it impossible to dispose of its own production when the market was flooded with imported motors. The company had been granted a loan on the mortgage of its assets. The directors frankly put forward their case that their bankers were not prepared to increase their cash credit limit against raw materials and finished products, though they had large unsold stocks of motors and large stocks of copper wire. They had mentioned that their bankers were willing to co-operate with any other financial institution. They further made it clear

that if they did not get further advance against hypothecation of raw materials and finished products, they would have to close down the factory until the large stocks of electric motors floating in the market were absorbed. Closure would mean large financial loss and there was also the risk of some of the trained technicians leaving the company. On account of the standing of the company, the high quality of its products, and the integrity and ability of the management, it was decided to comply with the directors' request.

*Company F: (Guarantee given where machinery on Deferred Payment Terms):* This company applied for loan, after issue of Government's directive that importers of machinery from abroad must arrange for deferred payments for at least some part the cost of machinery, to be spread over 3 or 4 years. It was, therefore, necessary and in the ordinary course of business, that when they were mortgaging their entire fixed assets, they should also expect the lenders to give the guarantee required by the suppliers of machinery.

*Company G: (Underwriting):* In this case, the company had already secured a loan from a Government institution, against their fixed assets, on the condition that they would raise a certain amount by way of capital. Their scheme had been very critically examined and found quite feasible. They were setting up one of the industries which was going to help to reduce the shortage of that article. They had already secured subscription to the capital to the extent of Rs. 2 crores, and they were hesitating to invite the public to subscribe to a larger capital because of the temporary depression on the stock exchanges. It was absolutely certain that as soon as the sentiment of the stock exchange improved, their shares would be taken up. Though the shares were likely to remain on hand for some time, it was decided that it was good business to underwrite the shares.

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## CHAPTER VI

### FINANCING INSTITUTION'S SCRUTINY OF THE SECURITY

#### **Prevailing Circumstances Affect Acceptability of Security:**

New-comers to the field of industrial finance often want to know if there are no standard tests, which if satisfied, would assure the lender the safety of the advance.

Though industrial finance is primarily concerned with mortgage of the fixed assets of the company, it is not as simple as lending against the mortgage of a building. So long as the valuation of a building in a good locality is correct, nothing happens, in the next five or ten years, to reduce the valuation of the building by more than 40 % or 50 %—the margin retained by the lender.

There is nothing standard or static in industries. In the case of industrial finance, special circumstances of each case have got to be taken into consideration. Many factors—political, economical and sociological,—come into play, and the same type of industry might receive different consideration in different circumstances and in different places. A sugar mill can usually be granted a loan to put up a power alcohol plant to utilise the molasses, but if the factory is in a State, which is going to enforce Prohibition and discourage utilization of molasses, the application will have to be rejected. Similarly when there is shortage of foodgrains, in the country, applications from starch factories and biscuit factories will have to be rejected, because the Government controlling stocks of foodgrains will not release adequate quantities, for the factories to be able to run comfortably.

When World conditions are disturbed, as happened when the war broke out in Korea, there is a lull in the development of industries because the entrepreneur is uncertain whether he will get the machinery or the raw materials, required to be imported.

The Partition of India in 1947, threw India's economy out of gear for some years, because the usual sources of raw materials for the jute and cotton industries went with Pakistan and the factories which depended on jute and cotton remained in India. At that time hardly any entrepreneur was coming forward to set up or expand a jute mill or cotton mill until the raw material position had improved.

The character, capacity, and credit of the borrower are of course as important in industrial finance as in any lending.

*Character:* The integrity of the borrower must be clearly beyond question. Otherwise advantage may be taken of the opportunity that might arise to jeopardise the lenders' position.

*Capacity:* The ability to run an industry must embrace capacity to manage all departments of the industry. A person possessing only technical knowledge and ability to produce goods of the highest quality would be poor risk, if he did not understand the financial aspects.

Even when the industry is being managed by an industrialist of proved ability, there is no guarantee of success if he now handles a new line and puts up a factory miles away from his headquarters.

There is a reported instance of a brilliant, cultured wealthy gentleman of highest integrity, who had attained eminence in public life, had also run many industries successfully and had started a new type of industry hundreds of miles from the scene of his previous activities. While he himself looked after the new concern, it ran very well and its products commanded ready market for the excellence of their quality, but when he went back to his place and left the management to his young inexperienced son, the organisation disintegrated and the concern had to be sold.

The instance vividly illustrates how success of otherwise of a venture depends on the capacity of the person actually managing the concern.

All the under-developed countries, forcing the pace of industrialisation, will for some time be confronted with the shortage of men of proved managerial abilities, but the risk of losses will be greater, where the tendency to entrust the undertak-



ing to inexperienced and incompetent relatives or political sympathisers, instead of gifted outsiders, will be pronounced. In such circumstances the lenders will require more frequent information, carry out inspections at shorter intervals, and will lay down conditions forbidding appointments to general-managements without the lender's approval.

*Credit:* Many new industrial ventures have 'teething troubles' in the beginning, which may hold up production or bring down the sales on account of faults in the product. In such circumstances larger finance is required than anticipated. The persons in control of factory who have either larger resources or credit, are able to meet the additional demands for funds.

### Real Security:

Since the long term loans are made against the capital assets of the company, including both the existing assets and those to be acquired out of the loan, the security is calculated as follows:

#### *A. Present value of existing Fixed Assets:*

Land ... ..	Rs.	5,00,000
Building ... ..	Rs.	20,00,000
Plant & Machinery ... ..	Rs.	75,00,000
Other assets ... ..	Rs.	—

A. Total Rs. 1,00,00,000

#### *B. Assets to be acquired out of the loan.*

Land ... ..	Rs.	—
Building ... ..	Rs.	10,00,000
Plant & Machinery ... ..	Rs.	40,00,000
Other assets ... ..	Rs.	—

B. Total Rs. 50,00,000

Total of A plus B Rs. 1,50,00,000

In case, the above assets are offered by a paper mill it would, in the ordinary course, get a loan of Rs. 75,00,000, according to the accepted standard of lending upto 50 % of the value of the block to be built up.

But if the paper mill is being run by cautious yet progressive industrialists of proved competence and their scheme of expanding the production of paper, which is in short supply, is sound, an industrial financing institution, could easily lend upto nearly 70% of the value of the total block assets they are going to have.

The proportion of the amount to be lent, to the value of the security, depends on the merits of the scheme and the capacity of management to work successfully the scheme to be financed, which is the real security.

It will not be wrong to say that in industrial finance the value of the physical security, in case of big projects, is largely national, except in case of new sugar mills, cotton mills or engineering concerns, which in case of failure of the concern can generally be sold at prices just enough to liquidate the loan.

The belief that an advance to an industrial concern against mortgage of its block assets is safe, if it does not exceed 50% of the value of mortgaged property, is based on the experience of small advances. It can be deemed theoretical in case of large industrial undertakings because it will be almost impossible to find a buyer for a large undertaking.

The real security is the assurance that the products of the company will be in demand for a number of years, and the capacity of the management to produce the article at a reasonable cost and to sell it in adequate quantities at remunerative prices.

It is not always that the pioneers of new industry perpetually remain in the lead and enjoy interrupted prosperity. The pioneers soon have competitors and only units managed by progressive managements, with drive, initiative, resources and capacity to satisfy a larger and larger number of purchasers, survive. This is illustrated by the history of the Automobile Industry in U.S.A.

The skill of those handling industrial finance is tested by their ability to grasp the specially favourable factors in the schemes examined, judging accurately the entrepreneurs' capacity to take the scheme to successful fruition and backing financially the promoters to the utmost extent so that they can comfortably put the scheme through.

*Capacity of Repay:* A company can repay a long term loan of Rs. 10,00,000, availed of against mortgage of its land, buildings plant and machinery, in say 10 years, if it can have an average excess of income over expenditure of over Rs. 2,00,000 every year over the 10 next years. The following profit and loss



account will show what are the items of expenditure and what are the heads under which a company derives income.

### Profit and Loss Account:

Rs.		Rs.	
Opening Stocks :		Sales less Returns:	55,40,000
Finished goods :			
Work in progress :	4,90,000		
Raw Materials consumed.	20,62,000	Closing stocks. Finished goods. Works in progress.	5,74,000
Consumption of stores.	3,98,000	Share transfer fee.	20
Power & Fuel.	3,14,000	Interest on call deposit.	1,100
Salaries, Wages & Bonus	3,71,000	Other Receipts.	13,000
Office salaries.	54,000		
Provident Fund contribution.	11,000		
Employees State Insurance contribution.	3,000		
Workmen & staff welfare expenses.	9,000		
Repairs to Plant & Machinery.	6,000		
Manufacturing expenses.	33,000		
Sales Tax	780		
Excise Duty	8,93,740		
Repairs to buildings.	30,000		
Insurance.	22,000		
Rent.	23,000		
Rates & Taxes.	4,000		
Audit & Legal fees.	2,000		
Directors Fees.	2,600		
Travelling Expenses.	32,000		
Motor Cars Maintenance.	19,000		
Interest.	2,19,000		
Miscellaneous expenses such as Printing, Stationery, Postage & Telegrams, General Charges, Publicity Propaganda, Bank Commission, Telephone charges etc.	36,000		
Packing & Forwarding.	75,000		
Commission & Discount.	35,000		
Selling agents commission.	26,000		
Sales Organiser's commission.	—		
Loss on sale of capital Asset.	—		
Managing Agents Remuneration.	72,000		
Depreciation written off.	5,85,000		
Balance being profit.	3,00,000		
	<hr/>		<hr/>
	Rs. 61,28,120		Rs. 61,28,120
	<hr/>		<hr/>

It will be seen that the income is mainly from sales. The expenditure is mainly on raw materials, wages, power etc. The excess of income over expenditure must be large enough to cover:

- (i) Dividends to the shareholders.
- (ii) Income Tax and other taxes on profits.
- (iii) Provision for reserve funds.

The above company's profit of Rs. 3,00,000/- may be utilized as follows:

Reserve Fund	...	...	Rs.	2,00,000
Payment of Dividend		...	Rs.	60,000
Provision for Taxes		...	Rs.	30,000
Balance carried forward to next years account.		...	Rs.	10,000

The company whose figures for a year's working have been used in illustration is presumed to be new company, which has borrowed Rs. 10,00,000/- against mortgage of its fixed assets. The large amount provided for depreciation indicates that there were not enough profits in previous years and some arrears of depreciation have been debited to profit and loss account this year.

This company will have augmented its financial resources by Rs. 7,85,000 ( Depreciation Rs. 5,85,000 plus amounts transferred to Reserve Fund Rs. 2,00,000 ). Loans against mortgages can only be repaid out of profits.

If it paid Rs. 1,00,000/- out of this amount towards reduction of the loan, it might not denote a bad position. If a company were not able to earn enough profit to provide for full depreciation and to transfer substantial sums to reserve fund, but was depending only on the amount of depreciation fund to liquidate the loan, it would be very unsatisfactory. Because having used, the accretions to its resources, from the depreciation fund, to repay the loan, the company will hardly have any resources to replace the machinery when it became old and inefficient. Of course if the useful life of the machinery was 20 years and the full depreciation was provided in 5 or 6 years, the argument will lose much of its force.



An academic question “Whether the instalments in repayments of loans should exceed the depreciation due on the building and machinery etc?” is often raised. Since the new companies cannot start repaying the loan until they have worked full two or three years, the depreciation caused by the wear of the machinery, during these years, will have accumulated and the instalments in the fourth or fifth year’s cannot be so large as to cover the previous two or three year’s depreciation. The instalments must really be fixed according to the earning capacity of the company and the durability of the machinery used. If the machinery is likely to last 20 years with only minor replacements, the period fixed for the repayment of the loan can be 10 years. If the machinery is such as is likely to be obsolete in 10 years the loan should be repayable in five years. The period of repayment and the terms of repayment are decided after taking into consideration the earning capacity of the company and the useful life for the machinery.

It is easy to judge the repaying capacity of a manufacturing company which has been in existence for some years, Their records and the balance-sheets show their cost of production, the prices realised and the profits made. Since the company would be borrowing for carrying out a scheme for renovation, modernization or expansion, its assumptions of slightly lower costs and better profits could be accepted. If a new company is establishing a cotton mill or sugar mill or a factory for manufacturing anything which is already produced in the country, it is too easy to check its calculations of cost of production and the price its products will realise, but when a company is starting a new type of industry which has not existed in the country, the borrower’s estimate of cost of production will have to be compared with independent calculations made by the lender’s experts. If the item which is to be manufactured was being imported, the invoice price will serve as a guide for checking the production cost, which should not work out higher than  $\frac{3}{4}$  of the price charged by the foreign manufacturer in his invoice. The foreign manufacturer’s cost of production must be lower than  $\frac{3}{4}$  of the invoice value but allowance will have to be made for the advantage the foreigner employs for being longer in the field and having larger markets.

The following balance-sheets of company A and company B indicate how company A is able to have a large output which it can sell at profit and can have no difficulty in repaying any loan availed of and how company B is finding it difficult to sell its production at remunerative rates and is therefore working at a loss.

Company : A :

BALANCE-SHEET.

Liabilities :		Assets.	
	Rs.		Rs.
Share Capital.	50,00,000	Fixed Assets.	52,00,000
		Value of Building & Machinery under Erection.	
		Value of Machinery Received.	
		Investment.	3,00,000
Reserves and Surplus.	16,00,000	Current Assets.	76,00,000
Secured Loans. (against stock).	21,00,000	Loans & Advances.	3,00,000
		Income Tax, paid in Advance.	3,00,000
Unsecured Loans. (Deposits etc.)	9,00,000		
Current Liabilities & Provisions.	25,00,000		
Provision for Taxation.	13,00,000		
Other Provisions.	4,00,000	Cash & Bank Balance.	7,00,000
Profit & Loss Account.	6,00,000		
	Rs. 1,44,00,000		Rs. 1,44,00,000



## Company B

### BALANCE - SHEET

**Liabilities :****Assets :**

	Rs.		Rs.
Share Capital	45,00,000	Fixed Assets	66,00,000
Reserves & Surplus	32,00,000	Investment	8,00,000
Secured Loans (against mortgage of block)	25,00,000	Current Assets	90,00,000
Secured Loans	53,00,000		
Unsecured Loans	15,00,000	Loans & Advances	9,00,000
Current Liabilities	15,00,000		
		Cash & Bank Balances	1,00,000
		Miscellaneous Expenses & Loss	11,00,000
	Rs. 1,85,00,000		Rs. 1,85,00,000

It is possible that company B is well managed but is experiencing temporary difficulties caused by sudden heavy taxes on the type of goods the company is producing and burdens imposed by legislation favouring the labour employed or because their programme of modernization or renovation has not yet started giving results.

One or two particular years results may not indicate the real strength and capacity of any concern. It is the company's intrinsic soundness that should be examined by the lender, making allowance for temporary adverse factors that might have caused the upsets.

#### Other securities and Important Contracts :

Every lender examines carefully the security offered for the loan and parts with his money only when he is satisfied that there is no risk.

But experience has taught him that certain percentage of his loans, for one reason or other, will involve him in full or partial loss and unless he has taken care to perfect his security he might lose his hold on it completely, or might have to part with it at a very low price, if he had not been vigilant to secure all rights to concession, leases, privileges, contracts which give the security its real value.

The mortgages, agreements and other documents executed by the borrower should always cover all the important points that will enable the lender to watch the security and facilitate the disposal of the security without impairing its value. The following points will serve as illustrations.

*Land:* The title to the land gives title to the structure on the land. If the title to the land is clear and marketable, the property can be easily conveyed to the buyer. In India different laws of succession govern people professing different Faiths. The local laws also differ. The documents in different States are drawn in the local languages and records are also kept in those languages. Examination of title to land is, therefore, entrusted to very able lawyers, who have contacts with leading lawyers in the States in which the lands are situated.

*Right to Appoint Directors etc. and Share in Management:* If the assistance is given by subscribing to share capital the lender must secure right to appoint certain number of Directors on the Board of the Company and might in some cases have to obtain a share in the management.

*Type of Mortgage Deeds:* Where the money is lent on mortgages, the deed should among other conditions, cover the right to appoint directors, to carry out inspections ask for statements etc. The mortgage deed should be further drawn up with the help of the best of lawyers and must be in a form, which will enable the lender to dispose of the mortgaged property without the intervention of the Court. It is a sad commentary on human nature, but it is true, that the borrower will promptly comply with all requirements before he gets the money. He will become slack once he has got the money and will not co-operate and may even



turn hostile if he has failed and the property mortgaged by him is required to be sold.

*Privileges:* If the borrower is enjoying certain privileges like permission to use roads or draw water from his relation's reservoir of water etc., the lender before he parts with the money must see that all the privileges enjoyed by the borrower are secured for the lender's nominees in case the lender is forced to sell the concern.

*Patent Rights:* Many factories are able to manufacture certain items because of their agreements with the owners of certain patents. The contracts by which the borrower has secured the concession to use the patents should be carefully examined. The right to use the patent should be available to the company for a fixed number of years and must accrue to the purchaser of the factory in case the original party to the agreement fails and the lenders have to sell the factory.

*Affiliation Contracts:* Many industrial concerns manufacturing machinery are working in collaboration with foreigners. Under the contracts the foreigners make available to them drawings, designs and technical assistance etc. The lender must make sure that the foreigners' collaboration will be available to the purchaser of the factory if it unfortunately fails to work successfully. It is true that this is not very easy because the foreigner may not like to commit himself to work with an un-known purchaser. The foreigners generally do not associate themselves with companies which are not likely to be successful and therefore, the question of making them agree to help the purchaser may not be important. But anything is possible in business and it is not rare to find concerns managed by experienced industrialists of highest integrity coming to grief on account of certain peculiar policies pursued by the Government. It, therefore, behoves every lender to study carefully the affiliation contracts.

*Rights to Raw Materials :* First class companies do not fail to have all rights to raw materials etc. in the company's names freedom to mortgage or assign the concessions. But in India some third class firms of managing agents obtain and retain the rights in the names of their firms or even in the name of some of

the partners of the managing agency firm. The idea generally is to make separate profits for the partners of the managing agency firm, by sale of the raw materials like coal, lime stone, etc., to the factory at highly remunerative prices.

The best course is for the company to own the sources of important raw materials. The next best is to have long term contracts securing rights to the raw materials.

If the company does not have the ownership or the long term contract and the defect passes unnoticed, the land, buildings, plant and machinery, by themselves, will be very poor security indeed.

*Contracts with Technical Consultants or Key Technicians:* The smooth and profitable working of some of the new types of industries depends on continuing guidance and services of technical consultants and key technicians. The lender has to be satisfied that the contracts are for sufficiently long periods to enable the factory to give rated production of the required standard for at least three years.

The lender must in many cases stipulate that the borrower is not allowed to dismiss the key technicians without the lenders approval. Every key technician, particularly if he is a foreigner, must have an Indian understudy capable of taking over in case of emergency or on the departure of the foreigner.

*Investments:* If the company has invested its funds for acquiring the control of an electric supply company supplying electricity to the factory or nearby coal mining company which is the main supplier of coal to the factory, the shares held by the company in the electric supply or coal mining company should also be got charged to the lending institution to ensure continuance of the supply of fuel and power.

### **Fortuitous Circumstances:**

When imports are drastically curtailed, some factories do well though they are not capable of producing certain chemicals or engineering products or spare parts of machinery to the required standard specifications. These factories have not got inherent strength and are bound to go to the wall as the production of better



organised competitors increases. Where it is found that the factories are doing well only on account of fortuitious circumstances and have not got the real intrinsic strength it is better to avoid entertaining their applications.

### **Actual Lending:**

The amounts to be lent to the industrial concern by way of medium and long term loans are often very large and sometimes exceed the value of the existing block. As these amounts are lent for putting up buildings and acquiring plant and machinery, they cannot be used immediately and therefore, there is no necessity to make the full amount available to the borrower immediately the loan is sanctioned. If a company is sanctioned a loan of Rs. 50 lacs for spending Rs. 10 lacs on buildings and Rs. 40 lacs on machinery, it will take at least 6 months to a year to complete the buildings and it might be between 6 and 18 months before they will have to pay for the plant and machinery. The amount, therefore, can be released as and when the company's obligations to pay for the buildings and plant and machinery mature. It is the experience that if companies get large amounts of funds in advance of their requirements, they are tempted to invest them in shares or loans etc., if not for the sake of speculation, at least for making up the interest they have to pay on the amount borrowed. The diversion of such funds has often led to heavy losses. The correct procedure is to take a phased programme of the company's requirements and to release the amount in instalments securing proofs of correct utilization of earlier payments, before the next instalment is paid. Periodical statements from the borrowers showing the progress made in putting up buildings and acquiring the machinery, and the check by inspecting officers, help in following the money spent and the progress made. The safety of the money lent has got to be guarded from two more risks, ( 1 ) the bank in which the amount is kept pending disbursement should be sound, (2) the bank must be prevented from exercising its lien on the amount, or utilizing it to reduce the company's existing unsatisfactory indebtedness. The first danger can be avoided by making the borrower name, for the lenders approval, the bank in which he is going to place the borrowed funds and the second risk can be

covered by making the borrower's bank give a letter that it will not have any lien on the money made available by the lender and kept with the bank by the borrower.

### **Proper Utilization :**

The medium and long term loans for large amounts are sanctioned to companies to put into effect the schemes proposed by them. It is natural that the lender should expect them to utilize the amounts, only for the particular parts of the scheme named in the proposal. If a company took a loan for establishing a composite cotton mill with spinning and weaving sections and later quietly dropped the idea of having the weaving section, it would be wrong. The lender would not have granted the loan to the mill of that size, if it was going to do only spinning, because a medium size mill producing only yarn is usually unable to make good profits continuously over a number of years.

The borrower generally drops parts of the scheme approved by the lender, when he finds that his calculations have gone wrong and he cannot complete the scheme within the original estimate. In doing this he harms himself and the lender. The partially executed scheme fails and the lender suffers a heavy loss while realizing the mortgaged assets.

Frequent and timely inspections to check how the amounts borrowed are being utilised for the particular types of buildings and machinery envisaged in the scheme, prevent abuse of funds. It is possible that some-times the company may get suggestions that it should use certain other processes and should therefore, go in for different types of machinery and curtail expenditure on certain items of building or machinery. Such diversions are allowed if the company takes previous sanction by discussing and convincing the lender that the alterations in the details of the scheme were necessary and desirable.

### **Difficulties in Achieving Progress According to Plan :**

Establishing and running a factory is a much more difficult task in India than in many of the advanced countries. The reasons are (1) The Government department giving the licence ( where



necessary ) to start the industry takes time to be convinced that the establishment of the industry is necessary and feasible. (2) Much time is consumed in getting leases and permits from the State Government where leases and permissions have got to be obtained. (3) The selection of machinery has got to be done after examining up-to-date machinery in various advanced countries and after studying the various new processes in vogue. This takes time. (4) If the machinery is to be obtained on Deferred Payment system it is a matter of prolonged negotiations, before the period, for which credit is to be obtained from the sellers of the machinery, is acceptable to both the sellers and the Government of India. (5) Where the machinery is of a specialised type, the manufacturers take 12 to 18 months to execute the orders. Since the machinery has to come from countries thousands of miles away it some-times happens that the vital parts of the machinery, however small, do not arrive in India in time and though everything is ready the plant cannot start working. (6) Where the industry is of a new type and there is a delay in getting the import permits or the delivery of the machinery, the top technicians engaged in foreign countries get appointments elsewhere and are not available and the search has to begin over again. (7) There is no knowing to what extent the Government of India will increase the import duty on the machinery imported and will therefore, increase the cost of the project.

There are two further difficulties. (i) The supply of electricity has not kept pace with the growing industrialisation and the increased demand for domestic consumption. As a result adequate power is not available in many places. (ii) Factories which require large areas of land find it difficult to purchase it by negotiations with several owners of small pieces. The State Governments can acquire the lands for the factories, but the routine is sometimes so slow that the entrepreneur cannot be blamed if he gives up in despair.

It is not all smooth sailing, after the factory, overcoming all difficulties in the preliminary stages, starts working. Where the factory is depending on raw materials or components to be imported from foreign countries, either the foreign country is not allowing

exports of those particular items for the Government of India is not releasing enough Foreign Exchange to permit imports of the raw materials and components in adequate quantities. The result is that the factory cannot work for adequate number of hours to have the minimum production to show profits. Some-times the factories do not get the transport facilities like railway siding in time and are handicaped in respect of receipts or raw materials or despatch of finished product and often incur losses on account of transport charges and breakages. It is not unknown for Indian factories to find the Government of India have, without notice raised freight rates on raw materials from particular localities. The Labour Legislation in India which enjoins payment of wages on certain assumed minimum standards of living, suddenly raises the cost of production beyond the capacity of the industry. The payment of wages not being related to the productive capacity or the skill, there is hardly any incentive for the un-skilled workers or the skilled workers to improve their performance. The lightning strikes and violent behaviour of the labour are special features in India and do much harm to the strikers and to the industry.

In the above circumstances a greater burden is thrown on industrial finance institutions in India to select the borrowers with care. It is quite fortunate that Indian businessman and industrialists have displayed business ability which is in no way inferior to their counterparts in advanced countries.

The difficulties enumerated above can be there even when the scheme is sound, the management well versed and experienced in running an industry.

### Failure or Success :

Starting and running a factory successfully is not easy as most people imagine. Otherwise the failures would not outnumber the successes on such a large scale.

*Failures among other causes were due to :*

- ( i ) Lack of experience of running any industry.
- ( ii ) Want of knowledge of the working of the particular industry and consequent failure to estimate requirements of capital or to ascertain cost of the production etc.



(iii) The idea of starting the industry originated on account of somebody's fancy, somebody's local patriotism or misplaced confidence of a person who had prepared a chemical in a laboratory or built up a crude machine in a shed.

(iv) Utter ignorance of financial aspects, like that where the promoters of a cotton mill, who could barely collect Rs. 1 lac, placed orders for machinery worth Rs. 10 lacs or spent it all in putting up a large building and ran out of funds before the roof-slab could be laid.

(v) Lack of organisation and programme.

(vi) Too many people endowed with authority to give orders independently.

(vii) Disputes among promoters.

**Success came to those who:**

(i) Handled a scheme within the financial resources they could command.

(ii) Were not ashamed to make a modest beginning so that they could work comfortably within the funds available.

(iii) Had equipped themselves with the knowledge of the industry or a similar industry.

(iv) Had got their estimates of capital, cost of production, expected prices for the products, examined by friends and experts.

(v) Placed full faith in the competent person selected to manage the affairs of the factory and had given him adequate powers to run the day-to-day administration efficiently.

(vi) Had infinite capacity to take pains to remove all difficulties.

(vii) Were endowed with intelligence, experience and energy to tackle all problems as they arose, for instance if one source of raw materials was closed for some time they were well posted as to the alternative source or if a part of a machine had broken and was not available in India, they could get it flown to India rather than helplessly shut down the machine and lose production.

(viii) Had the foresight not to invest every available penny in the venture, but to have a reserve of money and credit to meet contingencies.

(ix) Had on the Board, people of experience and integrity, who were likely to give sound advice and were not inclined to meddle or try to gain selfish advantages.

(x) Believed in continuous but steady progress built on efficient production, honest dealings, fair treatment of workers and reputation for standing by their commitments.

(xi) Paid the greatest attention to financial aspects of every commitment and transaction.

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## CHAPTER VII

### RELATIONS DURING CURRENCY OF LOAN

The loans for industrial finance are for long periods. During this time many factors help or hinder the progress of the borrower. More often the setbacks are due to causes beyond the control of the borrower.

The financing institutions command large resources, and can, to a certain extent, influence Government decisions by representations, have connections with eminent financial and technical experts and by their contacts with leading industrialists are able to assist the borrower in various ways.

The borrowers, who take the distinguished lenders into their confidence, as soon as the difficulties loom on the horizon are always benefitted by the timely help and advice. Those, who through misunderstanding or feeling ashamed or apprehensive, delay communicating the misfortune, till after damage is done, must thank themselves for their lack of frankness and alertness.

The Commercial Banks with their long, wide and varied experience have developed the technique of nursing their borrowers, temporarily crippled by stunning unexpected blows in their business. This prudent and sympathetic "nursing", even by giving further advances, has saved them from heavy losses or have appreciably reduced their losses and have created confidence in the business world that the bankers always stand by their honest clients.

The industrial finance institutions are of recent origin, they must develop their own traditions of giving timely help in an adequate measure. As there is no standard or uniformity in misfortune, there cannot be a standard remedy. The diagnosis should be correct and the relief adequate.

It is possible that in certain circumstances additional loans will have to be made to the borrowers to make good the part of the working capital lost through losses incurred in keeping

the factory running short hours in the hope of getting coal, raw materials and steel, supplies of which were interrupted through no fault of the borrowers.

It might also happen that on account of rise in costs of production, due to new labour legislation or Government failure to curb prices, a factory, whose margin of profit is severely reduced will be faced with the alternative of increasing its production by expanding its capacity.

In deserving cases loans granted for expansion to a new type of industry will benefit the borrower and improve his repaying capacity.

No industrial finance institution can escape defaults in payments of instalments in repayment. The defaults do not always indicate lack of solvency. Some-times the payments are deferred with the idea of conserving the depleted cash resources or because funds expected by sales of products or surplus assets have failed to come in. The defaults should be investigated but the borrowers should be dealt with sympathetically when the difficulties faced by them have been due to circumstances beyond their control and the intrinsic part of the scheme or the overall position of the company are not seriously affected.

When defaults take place, the financial resources of the borrowers are really strained. It is not prudent to force them to pay with the next instalment the whole amount defaulted on the last instalment. The borrower must get breathing time to gradually make up the arrears.

The lenders, with intimate knowledge of financial machinery, wide contacts with various types of industrial organisations, and long experience in handling loans, can tackle with courage, sympathy and understanding all problems of the borrowers. The alert, sympathetic, and experienced lenders will have few bad debts and will have the satisfaction of having contributed to the rapid development of industries in the country.

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## CHAPTER VIII

### FUNDS FOR INDUSTRIAL FINANCE

#### **Institutions and Sources :**

Various types of institutions handling industrial finance have different types of sources from which they draw their funds for their operations. Some of them draw their resources from more than one type of source.

*Banks :* They can use a portion of their deposits for industrial finance. But as the amount to be invested in this kind of advances will be related to the total of their deposits and the nature of their deposits, the amount available with each bank will generally be limited.

*Governmental Institutions :* These generally should not lack funds if the Government's policy is framed carefully and followed with determination, but the advances from the governmental institutions will be restricted only to certain types of industries which are not able to raise finance from anywhere else.

*Semi-Governmental Institutions :* India has set up certain autonomous bodies to meet the medium and long term requirements of industries, each with sufficient paid-up capital to take care of losses. They are required to raise funds from the market for their lending operations on the guarantee of the Central or the State Government which has sponsored the establishment of the institution.

*Industrial Credit and Investment Corporation of India Ltd.:* Special kinds of institutions, like the Industrial Credit and Investment Corporation, get money from the International Bank for Reconstruction and Development and from the Government of India out of the P. L. 480.

#### **Extent of Operations :**

As the funds required by each of the above institutions for its operations would be larger than the capital of each of them,

except the banks, they will be required to raise them from the market. The funds, which the banks can use from their deposits, will be related to the total of their deposit and the stability of the deposits.

### **Rate of interest:**

If the operations are to be profitable, there should be adequate margin between the average rates paid on the borrowings and the average rates earned on the advances.

Since monies have to be borrowed for long periods, the interest rates paid are also higher. The skill of the financier consists in gauging correctly the trend of interest rates and the flow of repayments. There is the risk that if funds are secured at high rates of interest and repayments come in faster and earlier than expected, the institution will have on its hands large funds borrowed at high rates of interest, when the general level of rates has gone down and the new borrowers are not willing to pay higher rates. Institutions confining themselves to first class business will have to be prepared to cut their rates, on advances, as fine as possible.

There is another factor in industrial finance which cuts into the profits from the business. The lender has to secure the funds as soon as he makes the commitment to lend, but the borrower would not take and cannot be given the full amount of the loan immediately the documents are signed. He can draw the amount of the loan over a period in instalments. The funds earmarked for such commitments often remain on hand for some time and cannot, during that period, earn the high rate of interest paid on the long term borrowing. To recoupe this loss the lender is compelled to make a "Commitment Charge" expected to cover the difference between the rate he pays on his borrowings and the yield he gets on the funds while they lie idle. If the call for short term money rates are temporarily much lower the commitment charge does not cover the difference. The banks have a slight advantage over the other institutions in the matter, because they do not have to specifically earmark any funds against



commitments. Institutions, run on business principles, regulate their rates of interest on advances according to the quality of the advances and money market conditions.

### **Difference between borrowings from the World Bank and the Market :**

The borrowings from the market have the great advantage that the institution can use the funds for 10 or 15 years – the period for which they are borrowed – and use them over again in loans as previous loans are repaid. In the case of borrowings from the World Bank the amounts received in repayments have to be straight-away returned to the World Bank. Of course there is also the other side that if the loans have been repaid at a time when money rates are lower and investments are only possible below the rates at which the money has been borrowed, the institutions have to suffer a loss on account of the difference. But money rates do not as a rule remain low at a stretch for long periods and the threatened loss can be recouped if mistakes have not been made in investing the returned funds in securities which cannot] be easily sold without loss or in locking them in channels from which they cannot be withdrawn.

### **Repayments :**

The institutions, when they have handled industrial finance for some years, find that there have been active periods when more loans were granted and there were dull periods when the demand for accomodation was much smaller. The result of these cycles of activity and depression are seen in the volume of repayments, which varies in later years in relation to the business handled in previous years. Maintaining graphs of possible receipts and payments projected in advance over a number of years, gives a correct idea of the total amounts that are likely to be received and the total payments including repayment of the institution's own borrowings that will have to be made. This chart saves the institution from making hasty commitments by unnecesary borrowing fresh monies when its needs could be met from repayments. It is needless to say that the projected chart should be corrected from time to time by making alterations consequent on actual and feared defaults or better repayments.

The borrowers want a convenient schedule for repayment, allowing the longest period and lowest instalments. At the same time, some of them want to have the choice to repay the debts earlier in larger instalments if they could manage to do so. This is not fair. The lender borrows funds for long periods at certain rates of interest expecting that the loans will run over a certain number of years and will earn him the remunerative rate of interest fixed on the loans. He also arranges his schedule of financial commitments on the aggregate volume of repayments to be received. The lender's calculations would be upset if the borrowers were free to repay any amount of money, any time they liked. He has also to guard against the contingency of money rates coming down, enabling the borrowers to borrow elsewhere at lower rates of interest and dumping the money on the lender when his avenues of profitable re-investment have also shrunk. Equity demands that if a borrower wants to pay larger sums than that fixed by the instalments, he should compensate the lender by paying the mutually agreed compensation to cover at least a part of the probable loss likely to be caused to the lender by receiving larger repayments. The lender is always glad to see his borrower prosper and is prepared to accommodate him if he wants to repay his loan earlier out of unexpectedly larger profits made. Some kind of compromise is always arrived at when larger repayments come from genuine profits. No lender can tolerate any schemes designed to thrust larger or total repayments on him from monies borrowed elsewhere at cheaper rates.

### **Borrowings in Foreign Currency:**

Industrial concerns borrow in foreign currency, when they agree to pay for foreign machinery in the currency of the manufacturer's country or of the country of the manufacturer's choice, and enter into Deferred Payment arrangements. They often take straight loans in foreign currency, when the lender himself borrows from the World Bank in foreign currency to be able to lend to the borrower in foreign currency.

If the Foreign Exchange rates were stable there would be no risk. But the frightful devaluation of the Sterling and the Rupee in terms of the Dollar in 1949, has awakened the world to the



harmful consequences of devaluation to the nationals of the countries, whose currencies depreciate.

In 1953 when the Industrial Finance Corporation of India Act was amended the Central Government had agreed to the amendment that if Indian borrowers were compelled to take the loans in foreign currencies, the profit or loss on the foreign exchange at the time of repayment, on the basis of the rates at which loans were availed should go to the Government of India. This concession has since been withdrawn.

The lender or the borrower whoever takes the risk of fluctuations in the value of the currency of his country must do so with his eyes open.

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# **PART III**





# **FINANCING OF SMALL-SCALE INDUSTRIES**

## **CHAPTER I**

### **Part Played by Small-Scale Industries :**

Small-Scale industries play a great part in the industrial organisation in a country.

1. They relieve the larger plants of:—
  - (a) the necessity of having larger factory accommodation.
  - (b) the cost of maintaining too many machines for special jobs.
  - (c) the planning of production and machining of a large number of items.
  - (d) making of small parts.
  - (e) manufacturing a number of accessories.

The contracting out work by the larger factories to smaller factories, besides conferring the above benefits on the larger factories, leads to greater employment per unit of output and by widening the sphere of worker's training in manufacturing, brings about quicker growth of skilled labour. Some of these industries started on a small-scale are likely to expand into big workshops and as their number increases there will be potentialities of the industrial entrepreneurship, which is at present highly concentrated, being spread out.

2. They can undertake the production of various chemicals and chemical compounds which are important but are not required to be produced on a very large scale.

3. They can manufacture a large variety of consumer goods.

4. They can produce an assortment of goods to the order of various types of big industries.

The striking point about small-scale industries is that they are generally concentrated in or around the large industrial cities like Bombay and Calcutta. This is natural because the



bigger factories and workshops have small jobs to be done and they contract them out to the smaller workshops. Where small groups are flourishing in the mofussil, they generally specialise in meeting the needs for spare-parts of the particular type of machinery used in their areas. For instance workshops in Kolhapur mainly sustain themselves on making spare-parts for the oil engines, which are extensively used by the prosperous farmers in that district. There are also historical accidents which have led to the establishment of the Lock Industry at Aligarh, the Glass industry at Shikohabad and the Surgical Instruments Industry at Sialkot.

A number of progressive industrialists have been encouraging young, ambitious and technically qualified young men to start small workshops under their patronage. These young men who are working with the help and guidance of the big factories in many parts of India are doing well.

A number of small-scale units are working in the areas West of Delhi. A few of them produce articles, which can satisfy standard specifications but the majority of them, it is reported, put on the market articles which have not been tested or would not stand the tests. The defects might be due to lack of technical know-how or to want of proper equipment.

It is computed that small-scale industries contributed Rs. 970 crores to the national income in 1956-57 as against Rs. 890 crores by the larger factories. Statistics have also been quoted that in 1950-51 this unorganised sector of industry working on small-scale, provided employment to 11.5 million people which was four times as much as the employment in the organised sector in that year.

### **Definition of Small Scale Industry :**

It has not been possible to define precisely what is small-scale industry, but it is generally understood that small-scale industry connotes an industrial unit with the capital investment of not more than Rs. 5 lacs and a labour force not exceeding 50 workers when using power, and 100 workers when not using power.

**Who starts a Small-Scale Industry :**

(a) A small-scale industry is generally started by a single person usually with one or two second hand machines in a small room or shed which the founder rented or leased. The founder is usually a skilled mechanic trained in a large workshop. He has special aptitude for using machinery and has acquired some reputation as a skilled worker and has been doing repair jobs or rendering other services during his off time. There had come a time in his career when he felt he would have larger income and could put his ideas more freely and more effectively into practice, if he started on his own. Many small entrepreneurs of this type prospered quickly, if they were fortunate enough to get the continued support from larger factories in the first few years. The Second World War, which provided ample opportunities to those who had any kind of machine, greatly benefitted many small entrepreneurs, who had skill and some kind of machinery, and helped them to stabilise their positions.

(b) During the last war sons and relations of men with money had also put up small factories, which they ran with hired men. But many of these had to be closed as the work decreased and the factories had failed to create a reputation for themselves. The combined stimulus of Protection and curtailing of imports has again, at present, offered opportunities, along with others, to the sons and relations of men with money. Unless these persons have technical knowledge and real aptitude, they take up simpler jobs.

(c) Some ambitious technicians, have set up as small entrepreneurs and have taken up :

- (i) machining of precision parts and taking sub-contracts for making smaller parts and spares for big factories or bigger contractors,
- (ii) producing independently important chemicals and chemical compounds,
- (iii) manufacturing coated fabrics,
- (iv) making agricultural implements,
- (v) dyeing yarns for tailor's threads, and



- (vi) preparing of a variety of articles where the scientific knowledge of the entrepreneur will help him to produce better products even on a small scale.

In the absence of financial backing, they cannot have more machines, more material, and enough working capital to produce on a large scale and cannot wait for months for payments of their bills and the proceeds of the sales of their products.

### **How They Start :**

(a) Most of the worker-entrepreneurs cannot afford to buy first class machinery. They have, therefore, to make the beginning with second hand machines, some of which they have to recondition and adopt to suit their requirements.

(b) The sons and relations of men with money are generally able to buy one of two new machines.

(c) The technicians somehow collect a few pieces of machinery some of which are old and some new.

### **How They Fare :**

A mechanic starting on his own cannot undertake the manufacture of any particular item. He has to depend mostly on machining of castings. If he has experience in a foundry he might start with small castings. If he has contacts with larger factories or with middlemen, who secure contracts from bigger factories and pass them on to small workshops, he is kept continuously busy and is generally able to earn more than if he had continued in employment. When the industrial activity slackens, the bigger factories try to keep their staff busy by doing, under their own roof, most of the work which they would ordinarily have given out on contract. The bigger factories when they have spare capacity in some of their departments, even canvass work from other big factories. The small workshops, therefore, are hard hit when they really need work and have orders thrust upon them when they cannot cope with the work.

The small factories fare better if they get orders directly from bigger factories. If they get the work through middlemen their margin of profit is reduced.

If they want to work on their own, and produce a particular item, they have to face the following difficulties:—

- (i) they cannot keep enough stocks of raw materials,
- (ii) they do not get payments quickly for the production delivered by them,
- (iii) they do not easily get loans or credit,
- (iv) since shortages have developed in steel, pig-iron, paper, chemicals etc., even though they may have orders, they may not get the raw materials in sufficient quantities and are forced to reduce production when supplies run short,
- (v) much of their time and energy is often wasted in correspondence and in visiting offices, which issue permits and collect taxes and in cajoling creditors etc.,
- (vi) they find it difficult to sell their production profitably,
- (vii) when sales of the one article they are producing are slack, they try to produce one more item. The result is that they cannot handle enough production of either of the lines or the equipment for one of the two lines remains idle.

### **Sales:—Major Problem :**

The small scale producer makes components or parts for new machines and parts or accessories for motor cars or bigger machines which are required to be replaced so often, or manufactures consumer goods or processes some goods into higher priced articles. If he does not make them to the order of a big factory or a middleman or a merchant, he finds it difficult to sell his production.

He can devote more time and attention to production if he has a contract with a big factory to take up a very large part of his production. He is happy if he is manufacturing an item which is in great demand, but this happiness is also soon threatened because his success makes many more people produce the same article in competition.

Government is prepared to pay slightly higher prices for their purchases of products of small-scale factories. The government agencies, actually handling the purchases however, find it



difficult to accept many items tendered, because the quality is often below the standards expected. The small-scale producer also is often ignorant of the exact quarters from whom to secure the orders, which he can execute.

The purchasers require the specified quality and guarantee of punctual deliveries and are not prepared to place orders, until the small-scale producer has established his reputation. Most small factories are therefore at the mercy of middlemen, who leave them very little margin of profit.

Regimentation would appear to some, the best way to promote rapid development of a small-scale industry.

Regimentation however, has several draw-backs:

It requires vast and efficient organisation (a) to recognise merit, (b) to allot sufficient production to individual units and (c) to pay better rates for better quality.

If the organisation fails to function satisfactorily in any part of the country, great injustice will be done to really competent people, who are producing articles capable of satisfying the highest standards. Regimentation if it is introduced must provide enough work for every factory that comes into existence. But since this will not be possible until the factory has established a reputation, regimentation will leave no scope for new entrants. This will defeat the objects of promoting the growth of a small-scale industry. Regimentation might also work against the better class producers who might not get the higher prices which first class workshops now command on account of the quality of their workmanship. Another difficulty in regimentation would be to secure punctual deliveries from hundreds of people to whom different contracts might be assigned. Failure of one section will hold up the work of many other sections.

If the aim is to encourage small-scale industries, the best course would be to stamp out those people, who just manufacture imitations and spoil the business of the more efficient producers. If strict control is exercised over those who pass off shoddy goods in imitation of spare parts for motor cars and many accessories and spare parts for machinery, the really efficient will be benefitted and

will be able to handle more lines and make up for the quantity put on the market by indifferent producers. Business recognises only efficiency. Emotion has no place in business. No compunction should be felt for the hundreds of people who are helping dishonest merchants to pass off as genuine, third class articles which are mere imitations of the original imported articles.

People might toy with the idea of reserving certain fields for small-scale industries, but when the need for supply is large and urgent and machinery and know-how are lacking, it would be taking a great risk in giving effect to such an idea. In short economic forces must have full play where political compulsion cannot work. Credit from the banks on generous terms is the only remedy which can give the small entrepreneur the confidence to expend and the strength to withstand the forces which often compel him to dispose of his production at a loss.

### **The Process of Evolution :**

The small scale factories handle work of various types. Since most types of small concerns start in practically the same manner and have allied problems and meet the same fate, the history of a typical fairly successful work-shop in the mechanical engineering group, in which majority of the small factories are engaged, would give an idea of the process of evolution through which the small-scale industries have to pass and show how only those with skill, perseverance and some kind of financial backing survive. An imaginary name Ramchandra Engineering Works is used.

### **History of the Ramchandra Engineering Works :**

Ramchandra was a mechanic in the Great Port Engineering Works Ltd., for 10 years. He had studied upto the IIIrd standard. He had an aptitude of handling machinery, took interest in the erection of new machines when they came, and watched the working of as many machines as he could. He would offer to help to any other mechanic in his difficulties and thus became acquainted with working of more and more machines. His services were in demand when any repair work was to be done. During the war he came in contact with smaller factories and



began to help them in reconditoning machinery. He had, in the meantime, secured on rent an old lathe which he had successfully reconditioned and was able to do small jobs in his spare time.

At this stage he felt that if he started his own workshop, he would earn much more and would be able to put into practice his ideas as to how many of the operations could be done quicker, with better results.

His landlord allowed him to build a shed for himself. When he came in contact with one or two big factories, which could give him sufficient volume of machining, turning and allied type of work, he gradually added one more small lathe and drilling, cutting, turning and welding machines.

While factories from whom he had received the contracts had enough orders, they were paying him well and promptly. But when their business slackened, the work was less and payments came long after the goods were delivered. He had to pass through anxious times and he had to plead with his workers to take payments in dribblets.

Later on when better times came, the factories which used to give him contracts expanded, they offered him increased work. The proprietors, who were friendly to him however, had no time to look to the detailed working of the expanded factories and he had to deal with the subordinates, who did not appreciate the long connection and the reputation which Ramchandra had built up. Though they continued to give him work, they cut down his rates. The payments now began to come in regularly, as soon as the goods were delivered. His margin of profit however had been drastically reduced. If the order was large and it took him over a month to execute the entire order, the managers and accountants of the expanded factories did not pay him till the whole order was executed and he was again experiencing difficulties in paying his workers. A protracted strike in the factory of one of his few big patrons, greatly curtailed the volume of the work available.

His skill in his work and the fight he had carried on for years had given him confidence in his ability, and the only way he could see, to reduce his dependence on contracts and

sub-contracts, was to start manufacturing independently spare parts required by many users of machinery and some motor car accessories required by trucks. For one year he sold amongst or through his friends, his small output of two kinds of accessories.

When he had established a very good reputation for the quality of one of his products, offers for financial help began to come in, but always with strings attached. He did not want to lose his independence and to give out his secrets. He had to wait till he succeeded in securing, on satisfactory terms, the co-operation of a well to do middle class gentleman.

The financial assistance enabled him to increase his production and the peace of mind helped him improve his quality and to increase his sales. He started dealing with a small local bank.

When the public was convinced that the particular accessories could be made in India, the demand for them increased and also brought a crop of immitators.

The situation so developed that either he expanded production and tried to meet the increased demand or allowed the competitors to exploit the market he had developed by his own skill and hard work.

Even a modest expansion meant more space, more men, more machines, more material and undoubtedly more money for all these. He had some profits but had ploughed most of them back in purchasing machines and in erecting sheds. His friend, who had helped him so far could not put in more money. Other friends however, came forward to contribute funds. The bank agreed to lend him against raw materials and finished products. The expansion was an accomplished fact.

When all was set fair for uninterrupted progress, Government curtailed imports of steel. The scarcity of the metal, brought down the production, rendered men and machines idle, but increased the need for ready cash to secure steel from whatever source it could be purchased or imported.

Purchasing in open market was un-remunerative. Importing meant delays, filling of forms or correspondence, which sapped all the energy.



Simultaneously with these difficulties his prosperity attracted the attention of many tax-gathering officials, and his expansion alerted many departments to see whether he had complied with their regulations. How he sometimes, wished he had continued in service!

The small bank with which he started dealings when the first financier befriended him, respected him for his honesty and had ample confidence in his ability, but could not extend the help beyond certain limits for the following reasons:

(i) if he bought steel in the open market, the bank could only value it at standard rates.

(ii) The bills on Government departments remained unpaid so long that the reasonable credit line that the bank could fix for him was soon utilised. His bank could not lend him further on bills until previous bills were paid.

(iii) The creating of a mortgage would lose support of the friends who had given him deposits or loans.

He is concentrating on job work and continuing producing the accessories in the hope that steel and pig iron will soon be available in larger quantities.

### **Comments on Arrangements in Existence and Arrangements Proposed:**

*A small entrepreneur should be given liberal help if he can produce a guarantor:* Government or Government sponsored institution's scrutiny of the standing of the guarantor is a long process.

A guarantor, who would be willing to stand surety for a friend to a commercial bank, will be unwilling to take the responsibility if the guarantee is to be given to a Government department or to an institution controlled by Government. He is afraid that Government might use any of the summary weapons they have got and attach and sell any of his properties for a meagre sum. People with sound common sense prefer giving cash to standing surety.

The guarantor often tries to repudiate liability unless the lender like a commercial bank, has some other hold on him.

*Association Should Stock Raw Material and Supply it to the Members:*—This is possible where all the members of the association are using the same quality of raw materials. For instance a Tin Smiths Association using a particular quality of plain or galvanized sheets can hold the stock. But this arrangement will have to be supported by regulations of the association covering every contingency. For instance (a) in what proportion the interest on the advance is to be paid, (b) what happens to the stocks unclaimed by any of the member, (c) when are the members to intimate their requirements, and (d) what happens if the indented goods do not come for months, (e) who keeps control of the stocks.

The members require raw materials of different specifications and the quantities which each of the small-scale worker requires, are very small. The well-to-do members of the fraternity are not prepared to be associated with their lesser bretheren in the quest for raw materials.

*The small scale industries should avail of loans from the State Bank of India by pledging raw materials and finished products:* If the portion required by the small factories for their daily consumption and sales is excluded, the remainder, will be hardly worth bothering about. The bank will require about 50% margin, will take hours to receive money and longer still, to send the godown-keeper to release the goods required.

### **Real Problem:**

Small-scale industries, no doubt play great part in the industrial organisation in many countries. If their participation in industrial production in India, is small the reasons are :

(i) This is really the first generation of technicians and mechanics. Therefore, there are fewer people with experience, vision and courage, who could face the trials and the risks, and become small scale industrialists.

(ii) Whenever the circumstances have been accidentally favourable, for the people with experience, to set up their own workshops, the dearth of trained men made the employers offer attractive remunerations. The better emoluments damped enthusiasm and spirit of adventure,



(iii) The increasing burden of laws and regulations to be observed deters honest hardworking people from entering fields, where they are likely to be fined or even imprisoned for slight omissions like failure to submit one of the several minor returns or to report a vacancy,

(iv) The structure of industrial organisation in the Country, is mainly based on "Everything under One Roof" principle.

(v) A lot of confusion is created by forgetting the difference between Cottage Industries and Small-Scale Industries. The former relate to handicrafts, are mostly operated without the aid of modern machines and give scope to inherited talent, the latter are modern factories on a miniature scale. The problems of both of them are different.

Encouraging small-scale industries has been a problem all over the world. Even in an industrially advanced country like the U. K. where the banking system is so well developed, there were complaints that the small-scale industries were not receiving adequate help from the banks and the Government had to appoint the Macmillan Committee. The essence of the problem of small-scale industries is the "gap" between what credit the borrower requires and what the lender is prepared to give him on the strength of his capacity and integrity. Unfortunately the gap keeps on widening and persists almost until he gets out of the "Small-scale" category. As his business increases the small entrepreneur requires correspondingly more space, more machines, more material and more money. Unless he is very fortunate to have connections with large factories which can pass on to him a large volume of very remunerative work or he is lucky to be able to select for manufacture some item which is in great demand and leaves him large profits, his own resources built up out of the profits of the business will never cover his growing needs.

The lender can be liberal if he had insurance against possible losses. Unfortunately money easily obtained is easily lost. Pumping out money generously without scrutiny, is wasted as surely as pumping too much water in the corn field. Therefore, it would appear that the best agency which can gradually extend more

and more accommodation to the small borrowers, as he proves his capacity and integrity, will be the local banks, who could take up greater risk if they are sufficiently compensated by Government

### **What help needed :**

In the present circumstances, in the country, both Government and the banks will have to play their parts well. On its part, Government will provide accommodation, supply machinery, give electric supply, make stocks of raw materials and components available, establish workshops for specialised processes like heat treatment and for lending the use of special purpose machines, which a small factory cannot possess. It will also review the laws regarding mortgage of land, building and machinery, simplify them, and make it easy to effect mortgages in favour of banks.

A small scale producer starting a workshop is very much perplexed because he does not get, in one place, full and correct information as to what laws and regulations he has to comply with. He should not be allowed to be harassed by the Staff of the departments of the Shop and Establishments Inspector Municipal Licensing Officer. Assessor and Collector of Taxes, Sales-Tax Collector and host of other authorities provided he has honestly informed the municipality of his intention to start a workshop. The Chamber of Commerce and the municipality should each nominate a person, who would offer all guidance and would secure all Licences. A reasonable fee should be charged.

### **Bank can help :**

The banks could take more interest in helping small-scale industries, but they will require some protection against losses. If Government makes available to them free of interest for 15 years one third the amount of the loans granted by them to small-scale industries and later formally approved by Government, the banks should be able to take much greater risk. Of course, if any approved loan is repaid before the time, the bank should return the amount advanced by Government, because the risk will then have disappeared and there will be no need for further compensation. Abundant P. L. 480 funds are available.



It might be argued that the banks in India are accustomed to work too much in the well-worn grooves and are not likely to take the slightest risk. There are reasons for it. Their deposits cannot increase rapidly. Government owned or Government sponsored institutions get undue facilities but the burden of financing the trades and industries falls on the commercial banks. They have little control over their expenses.

### Banking Commission :

There should be a Commission like the National Monetary Commission of U.S.A. (1907) to investigate all aspects of Banking in India and more particularly :—

- (i) what are the handicaps which prevent the banks from opening more branches ?
- (ii) what are the factors responsible for the unusual phenomenon that bank deposits are lower than the currency in circulation ?
- (iii) what are the consequences of nationalising the Imperial Bank of India ?
- (iv) what role must the State Bank of India really play to enable Government to give economic services in various fields ?
- (v) why are the people deserving credit not able to get loans against house property and personal security ?
- (vi) what are the changes needed in the laws of the country to facilitate credit being made available quickly and more liberally ?
- (vii) what part are the small banks expected to play and how can the State Bank of India guide, watch and help them ?
- (viii) should commercial banks make medium and long term loans to industries and what assistance could the Reserve Bank of India give them ?

- (ix) what can be done to relieve the banks in India of the necessity of studying and complying with the provisions of so many laws?
  - (x) how far can the banks work as agents of Government in rendering economic services to agriculturists and small-scale industrialists.
  - (xi) is it desirable to have a separate Bank like the old Yokohama Specie Bank, Japan, to help in promoting the foreign trade of India ?
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# **PART IV**





# **SOME INTERNATIONAL FINANCE INSTITUTIONS**

## **CHAPTER I**

### **The International Bank for Reconstruction and Development:**

The International Bank for Reconstruction and Development is mainly concerned with the provision of long-term credits for reconstruction and development. It is an agent of giant stature and unimpeachable standing with whose aid the production may be generally stimulated and private investment encouraged in all countries of the world.

At the end of the Second World War there was unprecedented need for foreign capital. Even industrially advanced countries had their productive capacity seriously impaired by war and were not in a position to provide capital goods or the savings required for investment in reconstruction. The under-developed countries naturally had not sufficient resources to tackle the large development programmes necessary for their progress and were dependent on foreign capital. Other countries, which could be deemed to be sufficiently well placed in the matter of internal resources had to have recourse to foreign capital to supplement their needs.

In the Post-war years, private capital was expected to be inadequate to meet the task of reconstruction in most of the countries. It was also likely to be too shy to venture outside the frontiers of the countries because of unfortunate experiences of depreciating currencies and was more likely to be restricted in its movement on account of exchange control regulations. The Bank by pooling the risk can reduce the premium on the risk and can expect to coax private capital accross international boundaries through its agency.

The Bank cannot meet all the needs of international investment but by directing its help at strategic points, it can stimulate the



revival or development of industry and agriculture. In the under-developed areas the Bank by financing projects basic to development can create conditions in which industrial development becomes possible. For instance the Bank's help in the fields of education, health, road construction, irrigation, reclamation and like projects, which cannot be financed from private investment, can help the countries in creating conditions which will make industrial development possible.

Development is a slow process, while reconstruction can be done much quicker. The Banks' earlier loans were, therefore, given to War-devasted countries like France, Netherlands, Denmark etc., for reconstruction. The later loans are all deemed to be development loans. The Bank considers its main task as that of encouraging the flow of private capital from countries where it is relatively plentiful to countries where the capital is relatively scarce.

The Bank's Articles of Agreement lay down that except in special circumstances, its loans should be made for specific projects of reconstruction and development, the more useful and urgent projects being dealt with first. The Bank is not averse to financing national development programmes but they should be properly worked out in terms of projects by which the objectives of the programme are to be attained.

The Bank grants loans to countries or to private enterprises or financing institutions in the countries if they are guaranteed by the Government of the country in whose territories the industry is situated. Naturally the bank must be assured that the Government's handling of the economic situation is correct and that the country borrowing or guaranteeing is sufficiently solvent and likely to remain solvent during the currency of the loan. The Bank, therefore, with the aid of the International Monetary Fund, makes a study of the economic policies and financial stability of the countries before large loans are sanctioned to the countries or on their guarantees. The Bank is often asked to finance projects which would take many years for completion. The Bank as a financial institution is naturally reluctant to make commitments so far forward on the basis of mere plans. As the

lender, the Bank must satisfy itself that the funds placed at the disposal of the borrower are being properly utilised and that the integrated programme is being followed according to the schedule given to the Bank. The Bank has further to see that on account of changes in the Government in the countries, the policies are not changed and that the economic development will proceed on lines previously indicated to the Bank. Some resentment is shown against this stipulation on the ground that the borrower is not able to have definite plans so long as he has not got definite assurance of financial assistance. But since the Bank carries great responsibilities, it behoves the Bank to be careful and to see that the borrower realises his responsibilities and watches the progress of his own policies and projects more carefully than the lender.

As the lender, the Bank naturally expects the borrower to have some sources of his own. The Bank, therefore, prefers to lend to the country to the extent of the foreign exchange requirements of the project. The loans are expressed in terms of U. S. dollars but are repayable along with interest and other charges, in the currencies actually borrowed from the bank. Of course if the country whose currency was used permits it, the bank allows repayment in that currency.

Since the Bank grants loan for reconstruction and development it wants that more urgent projects should be handled first. It can make sure that the projects submitted are important and that they are likely to contribute to reconstruction and development, if it is allowed to investigate the overall economic position of the borrowing country with particular reference to its investment expenditure and the relation of individual projects to country's actual development needs.

A committee of experts makes a careful study of the merits of the proposal and makes recommendations. The Bank generally decides to make the loan after the experts have recommended the project.

The rate of interest charged by the Bank depends on the period of the loan. If the period is longer the rate is slightly higher.



This is because the Bank can borrow for short periods at a lower rate of interest. The rate fluctuates and follows the rate at which the Bank can borrow in New-York or London. The Bank charges commission of 1% in addition to the interest to enable it to build up a reserve fund commensurate with its liabilities. The Bank also makes a commitment charge, that is, charges extra 1% on the amount of the loan from the date it is effective and recovers it on the undrawn balance until it is fully drawn. This is justified on the ground that the Bank has usually to keep an unutilised amount equivalent to the amount of the loan sanctioned and has to go on paying interest on the amount borrowed.

When the loan is granted for a particular project the Bank insists that the amount is repaid in instalments. Even when the Bank grants loans to an institution which uses the Bank's loan for making loans to its borrowers, the amount of the loan repaid by the borrower to the institution has got to be returned to the Bank in the specified instalments and even earlier if the amount is repaid earlier by the borrower.

The authorized capital of the International Bank of Reconstruction and Development is \$ 10,000 million, divided in 1,00,000 shares of \$ 1,00,000 each. In January 1958 sixtyfour countries of the world had taken up 93.334 shares. The five largest shareholders are:—

U. S. A.	...	...	...	31,750 shares.
U. K.	...	...	...	13,000 „
China	...	..	...	6,000 „
France	...	..	...	5,250 „
India	...	...	...	4,000 „

China subscribed to these shares before the communists came into power. None of the Soviet block hold any shares. Only 20% is called up per share and the balance is uncalled liability of share-holders.

### Resources of the Bank

The resources of the bank consist of all the capital subscription paid by member Governments, the amount raised on bonds issued in the International finance markets such as New York, London

and Zurich and the amounts received from sale of bonds to the central banks in member countries. The Bank's operations have been successful and on June 30, 1957 it had raised \$ 1,033 million from the sale of its bonds. The bank has not, till now, found its resources inadequate to meet the needs even though the whole world is clamouring for capital. That the Bank's loans are not larger, in the aggregate, is mainly due to lack of well worked out projects for which the Bank can give loans. The lack of capital to finance local currency, expenditure, shortage of technical skill and monetary policy and economic instability due to unsound monetary and fiscal policy in many of the prospective debtor countries, have been cited in the Bank's annual report among other factors that have kept the Bank's lending to the levels reached.

The total loans granted by the World Bank since its inception about 12 years ago to 31st March 1958 aggregated to \$ 3,500 million of which \$ 2,704 million were disbursed.

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## CHAPTER II

### INTERNATIONAL FINANCE CORPORATION

The International Finance Corporation was created in 1956 in order directly to promote and assist private business particularly in the areas where private enterprise is in the pioneering stage. The International Finance Corporation has an authorised capital of U. S. \$ 100 million of which \$ 93.1 million has been subscribed by 54 members of the International Bank of Reconstruction and Development. The institution was created because the Bank, though it holds to the philosophy of encouraging and assisting private investment, found itself unable to directly aid private business because its articles prevented it from making loans to private enterprise without the guarantee of the Government in whose territory the enterprises were located. The International Finance Corporation has started working in earnest but it will have to be careful in its transactions. It will have to extend help not merely by loans but by participating in equity capital also. It is reported that they are having negotiations with one or two industrial concerns in India whose management enjoy highest reputation for integrity.

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## CHAPTER III

### EXPORT-IMPORT BANK U. S. A.

The bank was established by U. S. Congress in 1934 as an independent agency of Government to assist in financing and facilitating exports, imports, and exchange of commodities between United States and any foreign country or the agencies or nationals thereof.

Besides the paid-up capital of \$ 1 billion, the Bank is authorised to borrow upto \$ 4 billion from the U. S. Treasury.

The Bank in its career of 25 years has adhered to two principles.

- (i) The bank should supplement and encourage and not compete with private capital.
- (ii) The loans made should offer reasonable assurance of repayment.

The Bank extends credits to foreign purchasers of goods produced in U. S. A. and guarantees credits extended by banking organisations to foreigners buying goods made in U. S. A.

The Bank has not confined itself to the restricted role of facilitating exports and imports. It revised its policies and procedures to meet the changes in world conditions.

It gives preference to those transactions which would result in the export of U. S. capital goods, which when employed abroad will improve the economy of the importing country and make it a better customer of the U. S. A.

It encourages loans where the U. S. A. goods exported abroad will produce more goods and materials required by U. S. A.

It has participated in "Stabilization Loans" required by Latin American countries like Argentina, Brazil, Chile when the prices received by them for their exports had gone down and their economies were threatened.



It made credits available to Argentina, Brazil, Costa Rica, Mexico and some more Latin American countries for economic development. Had the bank not come forward with liberal and timely assistance, there would have been few lenders to assume the risks and fewer still to venture on bold development projects.

### **India and Export-Import Bank:**

For the first time in its history the Export Import Bank agreed to extend a credit of \$ 150 million to India in June 1958. This credit was really a part of the \$ 225 million aid programme of the U. S. A. Government in assisting India's Second Five Year Plan. The bank has recently, under what is known as the Cooley amendment to Public Law 480, been authorised to receive upto 25% of the proceeds in foreign currency of sales of surplus agricultural commodities, for loans to private enterprise. The loan granted by the Bank out of these funds can be made in the currency of the country where the agricultural commodities are sold and are subject to the following conditions.

May be made to:—

- (i) Private U. S. firms,
- (ii) Affiliates of U. S. firms,
- (iii) Certain private firms of other nationalities.

In the case of U. S. firms and their affiliates, these loans may be made for business development and trade expansion in that country. In the case of private firms of foreign countries, the loans may be made only to expand markets abroad for U. S. agricultural products. The loans will carry interest at rates comparable in the country concerned and can be repaid in that currency. There is a special stipulation that loans for manufacture of products to be exported to U. S. in competition with products produced in U. S. or for the manufacture or production of commodities to be marketed in competition with agricultural commodities will not be granted.

The Export Import Bank had since its inception upto the end of 1958 had authorised loans to the extent of \$ 10 billion of which \$ 6.6 billion had been disbursed and \$ 1785 million had not been used at all. More than half of the loans disbursed were repaid.

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## APPENDIX 'A'

### List of Acts kept handy by an efficient Industrial Concern.

1. The Companies Act, 1956.
  2. The Indian Income-Tax Act.
  3. Wealth Tax Act, 1957.
  4. The Industries (Development & Regulation) Act, 1951.
  5. The State Sales Tax Act, 1952.
  6. The Central Sales Tax Act, 1958.
  7. The Industrial Disputes Act.
  8. The Bombay Industries Relations Act.
  9. The Payment of Wages Act.
  10. The Provident Fund Act.
  11. The Workmen's Compensation Act.
  12. The Factories Act.
  13. The Contract Act.
  14. The Negotiable Instruments Act.
  15. The Sale of Goods Act.
  16. The Boiler Act.
  17. The General Clauses Act.
  18. The Capital Issues Control Act.
  19. The Companies (Donation to National Funds) Act, 1951.
  20. The Emblems and Names (Prevention of Improper Use) Act, 1950.
  21. The Societies' Registration Act, 1860.
  22. The Land Acquisition Act.
  23. The Trade Marks Act.
  24. The Copyright Act.
  25. The Gift Tax Act.
  26. The Stamp Act.
  27. The Foreign Exchange Regulation Act.
  28. The Bombay Village Panchayat Act.
  29. The Trade Union Act.
  30. The Minimum Wages Act.
  31. The Rent Control Act.
  32. The Bombay Shop & Establishment Act.
  33. The Central Excise and Salt Tax Act.
  34. The Employees State Insurance Act.
  35. Land & Sea Customs Act.
  36. The Insurance Act, 1938.
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## APPENDIX 'B'

( Extracts from )

# THE INDUSTRIAL FINANCE CORPORATION ACT, 1948

An Act to establish the Industrial Finance Corporation of India.

WHEREAS it is expedient to establish an Industrial Finance Corporation for the purpose of making medium and long-term credits more readily available to industrial concerns in India, particularly in circumstances where normal banking accommodation is inappropriate or recourse to capital issue methods is impracticable.

It is hereby enacted as follows :—

1. (1) This Act may be called the Industrial Finance Corporation Act, 1948.

(2) It extends to the whole of India.

(3) It shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint.

2. In this Act, unless there is anything repugnant in the subject or context,—

- (a) "Board" means the Board of Directors of the Corporation ;
- (b) "Corporation" means the Industrial Finance Corporation of India established by this Act ;
- (c) "Industrial concern" means any public limited company or co-operative society incorporated by (a Central Act or an Act of the Legislature of a State) or under any law for the time being in force and registered in India

which is engaged or is to be engaged in the manufacture or processing of goods or in shipping or in mining or in hotel industry or in the generation or distribution of electricity or any other form of power ;

[*Explanation.*— The expression “ processing of goods ” includes any art or process for producing, preparing or making an article by subjecting any material to a manual, mechanical, chemical, electrical or any other like operation ;]

- (d) “prescribed” means prescribed by rules or regulations made under this Act ;
- (e) “Reserve Bank” means the Reserve Bank of India ;
- (f) “scheduled bank” means a bank for the time being included in the Second Schedule of the Reserve Bank of India Act, 1934 ;
- (g) “underwriting” means contracting, with or without conditions, to subscribe for stocks, shares, bonds or debentures of an industrial concern with a view to the resale of the whole or any part thereof.

6. (1) The general superintendence and direction of the affairs and business of the Corporation shall be entrusted to a Board of Directors which may exercise all powers and do all acts and things which may be exercised or done by the Corporation.

(2) The Board in discharging its functions shall act on business principles due regard being had by it to the interests of industry, commerce and the general public.

(3) In the discharge of its said functions, the Board shall be guided by such instructions on questions of policy as may be given to it by the Central Government.

(4) If any dispute arises between the Central Government and the Board as to whether a question is or is not a question of policy, the decision of the Central Government shall be final.

(5) If the Board fails to carry out the instructions on the question of policy laid down by the Central Government, the



Central Government shall have the power to supersede the Board and appoint a new Board in its place to function until a properly constituted Board is set up. The decision of the Central Government as to the grounds for superseding the Board shall not be questioned in any Court of law.

19. The Corporation may open Deposit Accounts with the Reserve Bank or with any agency of the Reserve Bank other than a Government treasury (or in consultation with the Reserve Bank, with a scheduled bank or a State Co-operative Bank).

20. The Corporation may invest its funds in the securities of the Central Government or of any (State) Government.

21. (1) The Corporation may issue and sell bonds and debentures carrying interest for the purpose of raising its working capital :

Provided that the total amount of bonds and debentures issued and outstanding and of the contingent liabilities of the Corporation in the form of guarantees given by it or underwriting agreements entered into by it shall not at any time exceed (ten times) the amount of the paid-up share capital and the reserve fund of the Corporation.

(2) Bonds and debentures of the Corporation shall be guaranteed by the Central Government as to the repayment of principal and the payment of interest at such rate as may be fixed by the Central Government on the recommendation of the Board at the time the bonds and debentures are issued.

(3) The Corporation may, for the purpose of carrying out its functions under this Act, borrow money from the Reserve Bank,—

- (a) repayable on demand or on the expiry of fixed periods not exceeding ninety days from the date on which the money is so borrowed, against securities of the Central Government or of any State Government ; or
- (b) repayable on the expiry of fixed periods not exceeding eighteen months from the date on which the money is

so borrowed, against securities of the Central Government of any maturity or against bonds and debentures issued by the Corporation under sub-section (I) and guaranteed by the Central Government and maturing within a period not exceeding eighteen months from the date on which the money is so borrowed :

Provided that the amount borrowed by the Corporation under clause (b) shall not at any time exceed three crores of rupees in the aggregate.

(4) The Corporation may also, for the purpose of carrying out its functions under this Act, borrow money from the Central Government on such terms and conditions as may be agreed upon :

Provided that the total amount borrowed by the Corporation from the Central Government under this sub-section and from the Reserve Bank under clause (b) of sub-section (3) together with the amount of bonds and debentures issued under sub-section (1) and outstanding shall not at any time in the aggregate exceed (ten times) the amount of the paid-up share capital and the reserve fund of the Corporation.

22. The Corporation may accept from any State Government or local authority, or any person deposits repayable after the expiry of a period which shall not be less than five years from the date of the making of the deposit, and on such other terms as it thinks fit :

Provided that the total amount of such deposits shall not at any time exceed ten crores of rupees.

23. (I) The Corporation shall, subject to the provisions of this Act, be authorised to carry on and transact the following kinds of business, namely :—

- (a) guaranteeing, on such terms and conditions as may be agreed upon, loans raised by industrial concerns which—
  - (i) are repayable within a period not exceeding twenty-five years, and



(ii) are floated in the public market ;

(aa) guaranteeing on such terms and conditions as may be agreed upon, deferred payments due from any industrial concern in connection with its import of capital goods from outside India :

Provided that no such guarantee shall be given without the prior approval of the Central Government ;

- (b) underwriting the issue of stock, shares, bonds or debentures by industrial concerns ;
- (c) receiving in consideration of the services mentioned in clauses (a) and (b) such commission as may be agreed upon ;
- (d) retaining as part of its assets any stock, shares, bonds or debentures which it may have to take up in fulfilment of its underwriting liabilities, so however that it disposes of the stock, shares, bonds or debentures so acquired as early as practicable but in no case, the stocks, shares, bonds or debentures so acquired shall be retained beyond a period of seven years from the date of such acquisition, except with the permission of the Central Government ;
- (e) granting loans or advances to, or subscribing to debentures of, industrial concerns, repayable within a period not exceeding twenty-five years from the date on which they are granted or subscribed to, as the case may be ;
- (ee) acting as agent for the Central Government or, with its approval, for the International Bank for Reconstruction and Development in the transaction of any business with an industrial concern in respect of loans or advances granted, or debentures subscribed, by either of them ; and
- (f) generally, the doing of all such matters and things as may be incidental to or consequential upon the exercise of its powers or the discharge of its duties under this Act.

(2) No accommodation shall be given under clauses (a) and (e) of sub-section (I), unless it is secured by a sufficient pledge, mortgage, hypothecation or assignment of Government or other securities, stocks, shares or secured debentures, bullion, movable or immovable property or other tangible assets in the manner prescribed by regulations or unless it is guaranteed as to the repayment of principal and the payment of interest by the Central Government, State Government, a scheduled bank or a State Co-operative Bank.

24. The Corporation shall not enter into any arrangement under clauses (a) and (e) of sub-section (I) of section 23 with a single industrial concern for an amount exceeding one crore of rupees in the aggregate:

Provided that the aforesaid limit of one crore of rupees shall not apply to any such arrangement when any loans, advances or debentures are, on the recommendation of the Corporation, guaranteed by the Central Government as to the repayment of the principal and the payment of the interest.

25. (I) In entering into any arrangement under section 23 with an industrial concern, the Corporation may impose such conditions as it may think necessary or expedient for protecting the interests of the Corporation, and securing that the accommodation granted by it is put to the best use by the industrial concern.

(2) Where one of the conditions imposed is that one or more Directors shall be appointed by the Corporation on the Board of Directors of the industrial concern to protect the interests of the Corporation, such condition shall be valid notwithstanding anything contained in the Companies Act, 1956, or any other law for the time being in force or in any instrument relating to the industrial concern and nothing in the said Act or in any such law or instrument in so far as it makes, in relation to a director, any provision for the holding of any share qualification, age limit, restrictions on the number of directorships, retirement by rotation or removal from office shall apply to any Director appointed by the Corporation in pursuance of this section.



**26. The Corporation shall not—**

- (a) accept deposits except as provided by this Act ;
- (b) subscribe directly to the shares or stock of any company having limited liability ;
- (c) grant any loan or advance on the security of its own shares :

Provided that nothing in clause (b) shall affect the right of the Corporation to acquire (any stock, shares), bonds or debentures of a company having limited liability in fulfilment of any under writing agreement entered into by the Corporation.

**27. (1)** Notwithstanding anything contained in the Foreign Exchange Regulation Act, 1947 or in any other enactment for the time being in force relating to foreign exchange, the Corporation may, for the purpose of granting loans or advances to industrial concerns, borrow, with the previous consent of the Central Government, foreign currency from the International Bank for Reconstruction and Development (or any bank or financial institution in India or in any foreign country) or otherwise.

(2) The Central Government may, where necessary, guarantee all loans taken by the Corporation under sub-section (1) as to the repayment of the principal and the payment of the interest and other incidental charges.

(3) All loans and advances to industrial concerns out of foreign currency borrowed under sub-section (1) shall be granted in Indian currency and shall be repayable by such concerns in the Indian currency.

(4) Any loss or profit accruing in connection with any borrowing of foreign currency under sub-section (1) for the purpose of granting loans or advances to any industrial concern or concerns or its repayment on account of any fluctuations in the rates of exchange shall reimbursed by, or paid to, the industrial concern or concerns, as the case may be.

**28. (1)** Where any industrial concern which is under a liability to the Corporation under an agreement makes any

default in repayment (of any loan or advance or any instalment thereof) or otherwise fails to comply with the terms of its agreement with the Corporation, the Corporation shall have the right to take over the management of the concern, as well as the (right to transfer by way of lease or sale) and realise the property pledged, mortgaged, hypothecated or assigned to the Corporation.

(2) Any transfer of property made by the Corporation in exercise of its powers under sub-section (1) shall vest in the transferee all rights in or to the property transferred (as if the transfer) had been made by the owner of the property.

(3) The Corporation shall have the same rights and powers with respect to goods manufactured or produced wholly or partly from goods forming part of security held by it, as it had with respect to the original goods.

(3A) Where the management of an industrial concern is taken over by the Corporation or any property is (transferred and realised) by it under the provisions of sub-section (1) all costs, charges and expenses (which, in the opinion of the Corporation have been properly incurred by it) as incidental to such management, (or transfer and realisation) shall be recoverable from the industrial concern, and the money which is received by it from such management (or transfer and realisation) shall, in the absence of any contract to the contrary, be held by it in trust to be applied, firstly, in payment of such costs, charges and expenses and, secondly, in discharge of the debt due to the Corporation, and the residue of the money so received shall be paid to the person entitled thereto.

(4) Where the Corporation takes over the management of a concern under the provisions of sub-section (1), it shall be deemed to be the owner of such concern for purposes of suits by or against such concern and shall sue and be sued in the name of the concern.

29. Notwithstanding anything in any agreement to the contrary, the Corporation may, by notice in writing, require any industrial concern to which it has granted any loan or advance to discharge forthwith in full its liabilities to the Corporation,—



- (a) if it appears to the Board that false or misleading information in any material particular was given in the application for the loan or advance ; or
- (b) if the industrial concern has failed to comply with the terms of its contract with the Corporation in the matter of the loan or advance ; or
- (c) if there is a reasonable apprehension that the industrial concern is unable to pay its debts or that proceedings for liquidation may be commenced in respect thereof; or
- (d) if the property pledged, mortgaged, hypothecated or assigned to the Corporation as security for the loan or advance is not insured and kept insured by the industrial concern to the satisfaction of the Corporation; (or depreciates in value to such an extent that, in the opinion of the Board, further security to the satisfaction of the Board should be given and such security is not given;) or
- (e) if, without the permission of the Board (any machinery, plant or other equipment), whether forming part of the security or otherwise, is removed from the premises of the industrial concern without being replaced ; or
- (f) if for any reason it is necessary to protect the interests of the Corporation.

30. (1) Where an industrial concern, in breach of any agreement, makes any default in repayment of any loan or advance or any instalment thereof or otherwise fails to comply with the terms of its agreement with the Corporation or where the Corporation requires an industrial concern to make immediate repayment of any loan or advance under section 29 and the industrial concern fails to make such repayment, then, without prejudice to the provisions of section 28 of this Act and of section 69 of the Transfer of Property Act, 1882 any officer of the Corporation generally or especially authorised by the Board in this behalf may apply to the District Judge within the local limits of whose jurisdiction the industrial concern carries on the

whole or a substantial part of its business for one or more of the following reliefs, namely :—

- (a) for an order for the sale of the property pledged, mortgaged, hypothecated or assigned to the Corporation as security for the loan or advance, or
- (b) for transferring the management of the industrial concern to the Corporation, or
- (c) for an *ad interim* injunction where there is apprehension of the machinery or the equipment being removed from the premises of the industrial concern without the permission of the Board.

(2) An application under sub-section (1) shall state the nature and extent of the liability of the industrial concern to the Corporation, the ground on which it is made and such other particulars as may be prescribed.

(3) When the application is for the reliefs mentioned in sub-clauses (a) and (c) of sub-section (1) the District Judge shall pass an *ad interim* order attaching the security or so much of the property of the industrial concern as would on being sold realise in his estimation an amount equivalent in value to the outstanding liability of the industrial concern to the Corporation together with the costs of the proceedings taken under this section with or without an *ad interim* injunction restraining the industrial concern from transferring or removing its machinery or equipment.

(4) Where the application is for the relief mentioned in sub-clause (b) of sub-section (1) the District Judge shall grant an *ad interim* injunction restraining the industrial concern from transferring or removing its machinery or equipment and issue a notice calling upon the industrial concern to show cause on a date to be specified in the notice why the management of the industrial concern should not be transferred to the Corporation.

(5) Before passing any order under sub-section (3) or sub-section (4), the District Judge may, if he thinks fit, examine the officer making the application.



(6) At the same time as he passes an order under sub-section (3), the District Judge shall issue to the industrial concern a notice accompanied by copies of the order, the application and the evidence, if any, recorded by him, calling upon it to show cause on a date to be specified in the notice why the *ad interim* order of attachment should not be made absolute or the injunction confirmed.

(7) If no cause is shown on or before the date specified in the notice under sub-sections (4) and (6), the District Judge shall forthwith make the *ad interim* order absolute and direct the sale of the attached property or transfer the management of the industrial concern to the Corporation or confirm the injunction.

(8) If cause is shown the District Judge shall proceed to investigate the claim of the Corporation and the provisions of the Code of Civil Procedure, 1908, shall as far as practicable apply to such proceedings.

(9) On an investigation made under sub-section (8) the District Judge shall pass an order —

- (a) confirming the order of attachment and directing the sale of the attached property, or
- (b) varying the order of attachment so as to release a portion of the property from attachment and directing the sale of the remainder of the attached property, or
- (c) releasing the property from attachment, if he is satisfied that it is not necessary in the interests of the Corporation, or
- (d) confirming or dissolving the injunction, or
- (e) transferring the management of the industrial concern to the Corporation or rejecting the claim made in this behalf :

Provided that when making any order under clause (c), the District Judge may make such further orders as he thinks necessary to protect the interests of the Corporation, and may apportion the costs of the proceedings in such manner as he thinks fit :

Provided further that unless the Corporation intimates to the District Judge that it will not appeal against any order releasing any property from attachment, such order shall not be given effect to until the expiry of the period fixed under sub-section (II) within which an appeal may be preferred, or if an appeal is preferred, unless the High Court otherwise directs until the appeal is disposed of.

(10) An order of attachment or sale of property under this section shall be carried into effect as far as may be practicable in the manner provided in the Code of Civil Procedure, 1908 or the attachment or sale of property in execution of a decree, as if the Corporation were the decree-holder.

(10A) An order under this section transferring the management of an industrial concern to the Corporation shall be carried into effect, as far as may be practicable, in the manner provided in the Code of Civil Procedure, 1908, for the possession of immovable property or the delivery of movable property in execution of a decree, as if the Corporation were the decree-holder.

(11) Any party aggrieved by an order under sub-section (7) or sub-section (9) may, within thirty days from the date of the order, appeal to the High Court, and upon such appeal, the High Court may after hearing the parties pass such orders as it thinks proper.

(12) Nothing in this section shall be construed, where proceedings for liquidation in respect of the industrial concern have commenced before an application is made under sub-section (I) as giving to the Corporation any preference over the other creditors of the industrial concern not conferred on it by any other law.

(13) The functions of a District Judge under this section shall be exercisable—

(a) in a presidency-town, by the High Court ; and

(b) elsewhere, also by an Additional District Judge.

30A. (1) When the management of an industrial concern is taken over by the Corporation, the Corporation may, by order notified in the Official Gazette, appoint as many persons as it



thinks fit to be the Directors of that industrial concern (and nothing in the Companies Act, 1956, or in any such law or instrument relating to the industrial concern in so far as it makes, in relation to a Director, any provision for the holding of any share qualification, age limit, restrictions on the number of directorships, retirement by rotation or removal from office shall apply to any Director appointed by the Corporation under this section.

(2) The power to appoint Directors under this section includes the power to appoint any individual, firm or company to be the managing agents of the industrial concern on such terms and conditions as the Corporation may think fit.

**30B.** On the issue of a notified order under section 30A,—

- (a) all persons, holding office as Directors of the industrial concern immediately before the issue of the notified order, shall be deemed to have vacated their offices as such ;
- (b) any contract of management between the industrial concern and any managing agent or any Director thereof holding office as such immediately before the issue of the notified order shall be deemed to have terminated;
- (c) the managing agent, if any, appointed under section 30A shall be deemed to have been duly appointed in pursuance of the (Companies Act, 1956) and the memorandum and articles of association of the industrial concern and the provisions of the said Act and of the memorandum and articles shall, subject to the other provisions contained in this Act, apply accordingly, but no such managing agent shall be removed from office except with the previous consent of the Corporation ;
- (d) the Directors appointed under section 30A shall take such steps as may be necessary to take into their custody or under their control all the property, effects and actionable claims to which the industrial concern is, or appears to be, entitled, and all the property and

effects of the industrial concern shall be deemed to be in the custody of the Directors as from the date of the notified order ;

- (e) the Directors appointed under section 30A shall be, for all purposes, the Directors of the industrial concern duly constituted under the (Companies Act, 1956) and shall alone be entitled to exercise all the powers of the Directors of the industrial concern, whether such powers are derived from the said Act or from the memorandum or articles of association of the industrial concern or from any other source.

**30C.** (1) Subject to the control of the Corporation, the Directors appointed under section 30A shall take such steps as may be necessary for the purpose of efficiently managing the business of the industrial concern and shall exercise such powers and have such duties as may be prescribed.

(2) Without prejudice to the generality of the powers vested in them under sub-section (2), the Directors appointed under section 30A may, with the previous approval of the Corporation, make an application to a Court for the purpose of cancelling or varying any contract or agreement entered into, at any time before the issue of the notified order under section 30A, between the industrial concern and any other person and the Court may, if satisfied after due inquiry that such contract or agreement had been entered into in bad faith and is detrimental to the interests of the industrial concern, make an order cancelling or varying (either unconditionally or subject to such conditions as it may think fit to impose) that contract or agreement and the contract or agreement shall have effect accordingly.

**30D.** (1) Notwithstanding anything contained in any law for the time being in force, no managing agent, managing director or any other director of an industrial concern shall be entitled to any compensation for the loss of office or for the premature termination under this Act of any contract of management entered into by him with such concern.



(2) Nothing contained in sub-section (1) shall affect the right of any such managing agent or managing director or any other director to recover from the industrial concern moneys recoverable otherwise than by way of such compensation.

30E. (1) Where the management of an industrial concern, being a company as defined in the (Companies Act, 1956), is taken over by the Corporation, then, notwithstanding anything contained in the said Act or in the memorandum or articles of association of such concern,—

- (a) it shall not be lawful for the shareholders of such concern or any other person to nominate or appoint any person to be a Director of the concern ;
- (b) no resolution passed at any meeting of the shareholders of such concern shall be given effect to unless approved by the Corporation ;
- (c) no proceeding for the winding up of such concern or for the appointment of a receiver in respect thereof shall lie in any Court, except with the consent of the Corporation.

(2) Subject to the provisions contained in sub-section (1) and to the other provisions contained in this Act and subject to such other exceptions, restrictions and limitations, if any, as the Central Government may, by notification in the Official Gazette, specify in this behalf, the (Companies Act, 1956) shall continue to apply to such concern in the same manner as it applied thereto before the issue of the notified order under section 30A.

31. The Corporation shall be deemed to be a bank for the purposes of the Banker's Books Evidence Act, 1891.

33. (1) A general meeting (hereinafter referred to as the annual general meeting) shall be held annually at a place in India where there is an office of the Corporation within (three) months from the date on which the annual accounts of the Corporation are closed ; and a general meeting may be convened by the Board at any other time.

(2) The shareholders present at the annual general meeting shall be entitled to discuss the annual accounts, the report of the Board on the working of the Corporation throughout the year and the auditors report on the annual balance-sheet and accounts.

34. (1) The affairs of the Corporation shall be audited by not less than two auditors duly qualified to act as auditors of companies under sub-section (1) of (section 226 of the Companies Act, 1956), one of whom shall be appointed by the Central Government in consultation with the Comptroller and Auditor-General of India and (the other auditor or auditors) elected in the prescribed manner by the parties mentioned in sub-section (3) of section 4 and such remuneration as the Central Government may fix shall be paid to the auditors by the Corporation.

(2) Every auditor shall be supplied with a copy of the annual balance-sheet of the Corporation, and it shall be his duty to examine it together with the accounts and vouchers relating thereto; and every auditor shall have a list delivered to him of all books kept by the Corporation, and shall at all reasonable times have access to the books, accounts and other documents of the Corporation, and may in relation to such accounts examine any Director or officer of the Corporation.

(3) The auditors shall make a report to the shareholders upon the annual balance-sheet and accounts, and in every such report they shall state whether in their opinion the balance-sheet is a full and fair balance-sheet containing all necessary particulars and properly drawn up so as to exhibit a true and correct view of the state of the affairs of the Corporation, and in case they have called for any explanation or information from the Board whether it has been given and whether it is satisfactory.

(4) The Central Government may (in consultation with the Comptroller and Auditor-General of India) at any time issue directions to the auditors requiring them to report to it upon the adequacy of measures taken by the Corporation for the protection of its shareholders and creditors or upon the sufficiency of their procedure in auditing the affairs of the Corporation, and



may at any time enlarge or extend the scope of the auditor or direct that a different procedure in audit be adopted or direct that any other examination be made by the auditors if in its opinion the public interest so requires.

(5) The Corporation shall send a copy of every report of the auditors to the Comptroller and Auditor-General of India at least one month before it is placed before the shareholders.

(6) Notwithstanding anything contained in the preceding sub-sections, the Comptroller and Auditor-General of India may, either of his own motion or on a request received in this behalf from the Central Government, undertake such audit and at such times as he may consider necessary :

Provided that where the Central Government is required to make any payment on account of the guarantee given by it under section 5 or sub-section (2) of section 21 or sub-section (2) of section 27, as the case may be, such audit shall be undertaken by the Comptroller and Auditor-General of India.

(7) Every audit report shall be forwarded to the Central Government and the Government shall cause the same to be laid before both Houses of Parliament.

35. (I) The Corporation shall furnish a statement in the prescribed form of its assets and liabilities as at the close of business on the last Friday of each month, or if that day is a public holiday under the Negotiable Instruments Act, 1881, as at the close of business on the preceding working day, to all shareholders within ten days from the date to which the statement relates.

(2) The Corporation shall furnish in the prescribed form to the Central Government and to the Reserve Bank at least once in every year or as frequently as the Central Government or the Reserve Bank may require a statement showing the classification of its loans and investments and of loans guaranteed by it and underwriting agreements entered into by it.

(3) The Corporation shall furnish to the Central Government and the Reserve Bank within four months of the close of the

**financial year** a statement in the prescribed form of its assets and liabilities as at the close of that year together with a profit and loss account for the year and a report of the working of the Corporation during the year, and copies of the said statement, account and report shall be published in the Official Gazette and shall be laid before Parliament.

37. No provision of law relating to the winding up of companies or corporations shall apply to the Corporation, and the Corporation shall not be placed in liquidation save by order of the Central Government and in such manner as it may direct.

41. (I) Whoever in any bill of lading, warehouse receipt or other instrument given to the Corporation whereby security is given or is purported to be given to the Corporation for any accommodation granted by it under this Act wilfully makes any false statement, or knowingly permits any false statement to be made, shall be punishable with imprisonment for a term which may extend to two years or with fine which may extend to two thousand rupees or with both.

(2) Whoever without the consent in writing of the Corporation uses the name of the Corporation in any prospectus or advertisement shall be punishable with imprisonment for a term which may extend to six months or with fine which may extend to one thousand rupees or with both.

(3) No Court shall take cognizance of any offence punishable under this Act otherwise than on a complaint in writing signed by an officer of the Corporation authorised by the Board in this behalf.

41A. The provisions of this Act and of any rules or orders made thereunder shall have effect notwithstanding anything inconsistent therewith contained in any other law for the time being in force or in the memorandum or articles of association of an industrial concern or in any other instrument having effect by virtue of any law other than this Act, but save as aforesaid the provisions of this Act shall be in addition to, and not in derogation of, any other law for the time being applicable to an industrial concern.



42. The Central Government may make rules, not inconsistent with the provisions of this Act, to give effect to the provisions of this Act and where there is any inconsistency between the rules and the regulations made under this Act the rules shall prevail.

43. (1) The Board may, after consultation with the Reserve Bank and with the previous sanction of the Central Government, make regulations not inconsistent with this Act and the rules made thereunder to provide for all matters for which provision is necessary or expedient for the purpose of giving effect to the provisions of this Act.

(2) In particular and without prejudice to the generality of the foregoing power, such regulations may provide for—

- (a) the holding and conduct of elections under this Act, including the final decision of doubts or disputes regarding the validity of elections ;
- (b) the manner in which and the conditions subject to which the first allotment of shares of the Corporation shall be made ;
- (c) the manner in which and the conditions subject to which the shares of the Corporation may be held and transferred, and generally all matters relating to the rights and duties of shareholders ;
- (d) the manner in which general meetings shall be convened, the procedure to be followed thereat and the manner in which voting rights may be exercised ;
- (e) the calling of meetings of the Board and of the Central Committee, fees for attending meetings thereof and the conduct of business thereat ;
- (ee) the delegation of powers and functions of the Board to the Chairman or to officers of the Corporation ;
- (f) the manner and terms of issue and redemption of bonds and debentures by the Corporation ;
- (g) the conditions which the Corporation may impose in granting loans or advances ;

- (h) the manner of determining the sufficiency of the security taken under sub-section (2) of section 23 ;
- (i) the manner and conditions subject to which the Corporation may borrow in foreign currency from foreign lenders ;
- (j) the forms of returns and statements required under this Act ;
- (k) the duties and conduct, salaries, allowances and conditions of service of officers and other employees and of advisers and agents of the Corporation ;
- (kk) the establishment and maintenance of provident or other benefit funds for employees of the Corporation ;
- (l) the disclosure of interest, direct, or indirect of a Director in any industrial concern ;
- (m) the taking over of the management of any industrial concern on a breach of its agreement with the Corporation and the powers and duties of Directors under section 30C ;
- (n) appointment of advisory committees for technical and other advice for purposes of this Act (fees for attending meetings thereof and the conduct of business thereat)
- (nn) the election of an auditor under sub-section (1) of section 34 ;
- (o) generally, the efficient conduct of the affairs of the Corporation.

(3) All regulations made under this section shall be published in the Official Gazette and shall come into force on such publication and shall also be laid on the table of Parliament.

M. A. K. Rao  
 12/10/1954  
 Bangalore  
 KMR  
 M. A. K. Rao



# ERRATTA

Page	Line	For	In-correct	Read	Correct
4	4	,,	Ordanance	,,	Ordnance
6	1	,,	Firms Individuals	,,	Firms and Individuals
10	15	,,	guaranteers	,,	guarantees
33	1	,,	meter section	,,	meter gauge section
38	31	,,	costs	,,	cost
41	3	,,	Employers	,,	Employees
56	16	,,	industrial Revolution	,,	Industrial Revolution
69	1	,,	following, day, week	,,	following, every day, week
71	6	,,	The will	,,	This will
81	24	,,	insert	,,	inert
87	28	,,	its	,,	her
92	20	,,	Duties nvestment	,,	Duties Investment
96	2	,,	Appendix A	,,	Appendix B
108	35	,,	I	,,	If
111	1	,,	Materials/Finished	,,	Materials/Finished Products
117	33	,,	companies	,,	companies'
128	33	,,	over looking	,,	overlooking
137	6	,,	national	,,	notional
144	33	,,	names freedom	,,	names with freedom
146	15	,,	before they will	,,	before it will
149	10	,,	to find the	,,	to find that the
149	26	,,	above can be	,,	above might be



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